# FILLING IN THE GAPS: SHAREHOLDER OPPRESSION AFTER *RITCHIE V. RUPE*:

# PART 1

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## I. TEXAS SHAREHOLDER OPPRESSION AFTER *RITCHIE V. RUPE*: WHAT'S LEFT?

On June 20, 2014, the Texas Supreme Court's decision in *Ritchie v. Rupe*[1] initiated a seismic shift in Texas law governing the protection of minority shareholders in closely-held corporations and limited liability companies.[2] After almost thirty years of steady appellate court development of a judicial remedy for oppressive conduct against minority shareholders, recognizing the trial court's power to force an oppressive controlling shareholder to purchase the oppressed minority shareholder's stock for a fair value,[3] the Texas Supreme Court suddenly announced that no common law cause of action for oppression existed[4] and that Texas courts had no power to order a buy-out under the statutory remedy for oppression.[5] Three dissenting Justices accused the majority of "extinguish[ing] meaningful protections for minority shareholders."[6] A host of academic articles[7] and continuing legal education papers

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[1] Ritchie v. Rupe, 443 S.W.3d 856 (Tex. 2014).

[2] The law protecting minority interests in partnerships, both general and limited, is not affected by the decision.

[3] *See, e.g.,* Kohannim v. Katoli, 440 S.W.3d 798, 811–13 (Tex. App.—El Paso 2013, pet. denied); Boehringer v. Konkel, 404 S.W.3d 18, 24 (Tex. App.—Houston [1st Dist.] 2013, no pet.); ARGO Data Res. Corp. v. Shagrithaya, 380 S.W.3d 249, 258 (Tex. App.—Dallas 2012, pet. denied); Cardiac Perfusion Servs. Inc. v. Hughes, 380 S.W.3d 198 (Tex. App.—Dallas 2012), *rev'd in part*, 436 S.W.3d 790 (Tex. 2014); Ritchie v. Rupe, 339 S.W.3d 275, 280 (Tex. App.—Dallas 2011), *rev'd*, 443 S.W.3d 856; Redmon v. Griffith, 202 S.W.3d 225, 234 (Tex. App.—Tyler 2006, pet. denied); Cotten v. Weatherford Bancshares, Inc., 187 S.W.3d 687, 699–701 (Tex. App.—Fort Worth 2006, pet. denied); Pinnacle Data Servs., Inc. v. Gillen, 104 S.W.3d 188, 196 (Tex. App.—Texarkana 2003, no pet.); Willis v. Bydalek, 997 S.W.2d 798, 801 (Tex. App.—Houston [1st Dist.] 1999, pet. denied); Davis v. Sheerin, 754 S.W.2d 375, 378 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

[4] *Ritchie*, 443 S.W.3d at 891.

[5] *Id.* at 872.

[6] *Id.* at 893 (Guzman, J., dissenting).

[7] *See, e.g.*, *Shareholder Litigation*, 26 BUS. TORTS REP. 267, 267 (2014) (labeling the *Ritchie* holding as "astonishing"); James Dawson, Ritchie v. Rupe *and the Future of Shareholder Oppression*, 124 YALE L. J. FORUM 89, 90 (Oct. 20, 2014), http://www.yalelawjournal.org/forum/ritchie-v-rupe (arguing that the Supreme Court "gutted the cause of action for shareholder oppression in Texas" and that the opinion was "wrongly decided," "bad law," "bad policy," and is "is likely to disincentivize investment in close corporations, ramp up the frequency of shareholder

from practitioners[8] both decried and applauded the demise of the shareholder oppression doctrine. The gloomy assessment: "In the wake of *Ritchie*, minority shareholders are already having a much tougher time in the courts."[9]

What protection is left for Texas minority shareholders? Did the majority opinion in *Ritchie v. Rupe* declare open season on minority shareholders in Texas? Actually, the answer is quite clearly in the negative. The Supreme Court made clear that quite a bit of protection is left for minority shareholders, and that there are several potential areas that are ripe for development. In the majority opinion, the Supreme Court cataloged the most common tactics that majority shareholders utilize to "squeeze-out" or "freeze-out" minorities.[10] The Supreme Court specifically held that "the foreseeability, likelihood, and magnitude of harm sustained by minority shareholders due to the abuse of power by those in control of a closely held corporation is significant, and Texas law should ensure that remedies exist to appropriately address such harm when the underlying actions are wrongful."[11] After an extensive analysis of the adequacy of statutory and common-law remedies already available to oppressed shareholders,[12] and the negative policy consequences of creating new duties that do not already exist,[13] the Court "decline[d] to recognize a common-law cause of action for 'shareholder oppression'"[14] that would impose new "common-law dut[ies] on directors in closely held corporations not to take oppressive actions against an individual shareholder even if doing so is in the best interest of the corporation."[15] The Court concluded that existing common-law duties

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oppression, and imperil the financial health of many small businesses"); ELIZABETH STONE MILLER & ROBERT A. RAGAZZO, 20 TEXAS PRACTICE SERIES: BUSINESS ORGANIZATIONS § 30:32 (3d ed. 2015) ("As a result of *Ritchie*, Texas has gone from being one of the jurisdictions most protective of minority shareholder rights in closely held corporations to one of the least protective jurisdictions.") [hereinafter TEX. PRAC.: BUS. ORGS.]. *See also* Lyndon Bittle & Kelli Hinson, *Texas Turns a Corner: Resolving Shareholder Disputes in Closely Held Businesses After* Ritchie v. Rupe, 67 BAYLOR L. REV. 339, 341 (2015), www.baylor.edu/content/services/document.php/253483.pdf ("The *Ritchie* opinion prompted immediate reactions by parties and commentators, ranging from sighs of relief to dismay and condemnation.").

[8] *See, e.g.*, Ricardo G. Cedillo, *Shareholder Oppression in Texas After* Ritchie *and* Sneed, State Bar of Tex. Prof. Dev. Program, Damages in Civil Litigation Course (2016); Elizabeth Stone Miller, *The Demise of the Shareholder Oppression Doctrine in Texas: Pursuit of Claims by Minority Shareholders (and LLC Members) After* Ritchie v. Rupe, State Bar of Tex. Prof. Dev. Program, Choice & Acquisition of Entities in Texas (2015); Thomas M. Fulkerson & Amy Moss, *Drafting Shareholders' Agreements in a Post*-Ritchie v. Rupe *World*, State Bar of Tex. Prof. Dev. Program, Advanced Business Law Course (2015); Eric T. Stahl, *Current Status of Derivative Litigation in Closely Held Corporations and LLCs Post*-Sneed *and* Ritchie, State Bar of Tex., Prof. Dev. Program, Advanced Fiduciary Litigation Program (2015).

[9] Dawson, *supra* note 7, at 94. *See also* Bittle & Hinson *supra* note 7, at 411 ("The Texas Supreme Court's decision in *Ritchie v. Rupe* altered the landscape of Texas law governing disputes between shareholders in closely held companies.").

[10] *See Ritchie*, 443 S.W.3d at 879 (listing "(1) denial of access to corporate books and records, (2) withholding payment of, or declining to declare, dividends, (3) termination of a minority shareholder's employment, (4) misapplication of corporate funds and diversion of corporate opportunities for personal purposes, and (5) manipulation of stock values" as most common squeeze-out techniques).

[11] *Id.*

[12] *Id.* at 879–89.

[13] *Id.* at 889–91.

[14] *Id.* at 891.

[15] *Id.* at 889.

and remedies "are sufficient."[16] The Court expressly recognized that "our conclusion leaves a 'gap' in the protection that the law affords to individual minority shareholders,"[17] and the Court did "not foreclose the possibility that a proper case might justify our recognition of a new common-law cause of action to address a 'gap' in protection for minority shareholders,"[18] nevertheless, for now, minority shareholders must seek the protection of those common-law causes of action that existed prior to the advent of the shareholder oppression doctrine in Texas.

We must take the Supreme Court at its word regarding the state and direction of the law. The majority opinion clearly indicated that the Court is not abandoning the role of the common law in protecting the interests of minority shareholders from oppressive conduct by controlling shareholders. Rather, the Court rejected the "shareholder oppression doctrine" as it had been developed in the appellate courts in favor of the application and development of more traditional approaches utilizing statutory remedies and contractual, tort, and fiduciary causes of action. It would be a fairer, and hopefully more accurate, assessment of the new direction charted by the Supreme Court to conclude that the Court is not abandoning minority shareholders so much as a challenging the bench and bar to address wrongdoing by means of existing, well-established legal concepts instead of seeking to innovate ad hoc remedies.

The purpose of this article is to take a fresh look at Texas law governing corporations in light of the *Ritchie v. Rupe* opinion and to focus on causes of action and legal duties that long predated the shareholder oppression doctrine, and that should be developed to fill in the gaps left by the Supreme Court's holding. This article takes up the Supreme Court's challenge by reexamining two lines of authority that were very well-established in Texas case law prior the advent of the shareholder oppression doctrine and that have been largely neglected after the shareholder oppression cause of action came to dominate this area of the law. Part One of this article analyzes how the shareholder oppression doctrine worked and what exactly are the "gaps" left by the *Ritchie* decision and then focuses on one line of cases, which had analyzed the legal relationship between shareholder and corporation and recognized that the corporation functions as a sort of trustee to the shareholder and owes quasi-fiduciary duties in connection with the shareholder's ownership interests. The enforcement of these recognized quasi-fiduciary duties through the court's equitable powers should, in a proper case, make available to an oppressed minority shareholder effective legal remedies, including the equitable remedy of a court-ordered buy-out. Part Two of this article re-examines the common-law tort cause of action for conversion as Texas courts have applied it to wrongful interference with ownership interests in stock and argues that this well-established cause of action already provides substantial protection to minority shareholders' interests, that the logical development of the existing case law would extend the stock conversion cause of action to more egregious examples of oppressive conduct, and that the damages remedy for stock conversion is the functional equivalent of a court-ordered buy-out.

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[16] *Id.* at 888.

[17] *Id.* at 889.

[18] *Id.* at 890.

## II. THE PROBLEM OF OPPRESSION IN CLOSELY-HELD CORPORATIONS

### A. Structure of the Corporation

The corporate structure allows the owners of a business to shield themselves from liability for debts incurred by the business, to securitize their ownership, to separate the ownership and control of a business so as to allow the existence of owners who are purely investors and are not required to manage the affairs of the business, and to make the business structure permanent and not subject to the whims of each of the participants. "A principal economic function of corporate organization is separation of ownership from control, so that entrepreneurs need not supply all the capital, and those who supply capital may diversify their investments and need not furnish managerial skills."[19] The corporate structure allows those with operations talent to manage and those with capital perform the investment function.[20]

A corporation is a separate legal person, distinct from the shareholders.[21] As such, the shareholders are the equitable owners of corporate property, but the corporation is the legal owner.[22] Shareholders do not directly control the corporation; rather, corporations are managed by directors, who are elected by the shareholders.[23] Because ownership is divided into multiple shares, except in situations where one person owns all of the shares or two persons own equal number of shares, it is a mathematical certainty that there will always be at least one person with a minority ownership interest in the corporation.

Directors are elected by the holders of a majority of the shares of the corporation and may be removed at any time, with or without cause, by a vote of the majority of the shares of the company.[24] Therefore, whoever controls the majority of the shares, controls who runs the company.[25] A shareholder may only own 51% of the shares, but because of the doctrine of

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[19] Hoagland *ex rel.* Midwest Transit, Inc. v. Sandberg, Phoenix & von Gontard, P.C., 385 F.3d 737, 747 (7th Cir. 2004).

[20] TEX. PRAC.: BUS. ORGS., *supra* note 7, at § 30:1.

[21] *See* Graham v. La Crosse & M.R. Co., 102 U.S. 148, 160–61 (1880) ("A corporation is a distinct entity. Its affairs are necessarily managed by officers and agents, it is true; but, in law, it is as distinct a being as an individual is, and is entitled to hold property (if not contrary to its charter) as absolutely as an individual can hold it."); Trustees of Dartmouth Coll. v. Woodward, 17 U.S. 518, 636 (1819) ("A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law."); TransPecos Banks v. Strobach, No. 08-14-00059-CV, 2016 WL 1169139, at *4 (Tex. App.—El Paso Mar. 23, 2016, pet. filed) ("A corporation is a separate legal entity from its shareholders, officers, and directors.").

[22] Sneed v. Webre, 465 S.W.3d 169, 191 (Tex. 2015); Humble Oil & Ref. Co. v. Blankenburg, 235 S.W.2d 891, 894 (Tex. 1951); Aransas Pass Harbor Co. v. Manning, 63 S.W. 627, 629 (Tex. 1901).

[23] *See* TEX. BUS. ORGS. CODE ANN. § 21.401(a)(2) (West 2013) ("The board of directors of a corporation shall . . . direct the management of the business and affairs of the corporation."). *See* TEX. PRAC.: BUS. ORGS., *supra* note 7, at § 30:1 ("Shareholders elect directors who then have the responsibility for managing the corporation's affairs. Once the directors are elected, shareholders have little say in management other than to vote on certain fundamental transactions."); *id.* § 30:2 ("A shareholder, as such, has little right to participate in management, save the right to elect directors, and vote on fundamental transactions.").

[24] BUS. ORGS. §§ 21.301–.303, 21.405, 21.409.

[25] D. Moll, *Shareholder Oppression in Texas Close Corporations: Majority Rule (Still) Isn't What It Used to Be*, 9 Hous. BUS. & TAX L. J. 33, 35 (2008), www.hbtlj.org/v09p1/v09p1mollar.pdf.

majority rule, that shareholder can place himself in 100% control of 100% of the corporate assets.[26]

The traditional attributes of corporate personhood, centralized management, perpetual existence, limited liability, and free transferability of ownership interests, work well for large, public organizations with numerous owners and are largely responsible for the popularity and growth of the corporate form among large entities.[27]

### B. Distinguishing Ownership in Closely-Held Corporations

A "closely-held" corporation is owned by a small number of shareholders whose shares are not publicly traded.[28] Closely-held corporations are typically characterized by substantial shareholder participation in the running and management of the corporation.[29] Sections 21.701 through 21.732 of the Texas Business Organizations Code provide special provisions and duties for "close corporations";[30] however, these statutory provisions apply only to corporations that elect to be statutory close corporations,[31] and very few do so. Therefore, the law applicable to almost all Texas corporations makes no distinction between large publicly-held and small closely-held corporations, even though the risks and benefits of stock ownership are vastly different as between those two types of organizations.

In public corporations, shareholders generally own stock with essentially no involvement in the business and management of the corporation. Shareholders participate in the financial success of the business both by receipt of dividends and increased market value of their shares, while taking absolutely no risk from their ownership of the business other than the loss of the price initially paid for their shares.[32] In public corporations, with a broad and diverse shareholder base, the principles of centralized control and majority rule rarely present a

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[26] TEX. PRAC.: BUS. ORGS., *supra* note 7, at § 30:1 ("Because directors are elected by shareholder vote, the board of a close corporation is typically controlled by the shareholder (or shareholders) holding a majority of the voting power.").

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> The traditional attributes of corporate status are: centralized management; perpetual existence; limited liability; and free transferability of ownership interests. Each of these corporate attributes is positive in the context of the public corporation. Indeed, these attributes are largely responsible for the popularity and growth of the corporate form among large entities. . . . However, as described in the next section, these attributes of corporate existence pose substantial problems, and may operate to defeat expectations, in the close corporation (i.e., a corporation with a small number of shareholders and no public market for shares).

*Id.*

[28] Ritchie v. Rupe, 443 S.W.3d 856, 878 (Tex. 2014).

[29] Moll, *Shareholder Oppression in Texas*, *supra* note 25, at 34.

[30] TEX. BUS. ORGS. CODE ANN. §§ 21.701–.732 (West 2015).

[31] *Id.* §§ 21.702(a), 21.705.

[32] *See* Moll, *Shareholder Oppression in Texas*, *supra* note 25, at 34 ("In the traditional public corporation, a shareholder is normally a 'passive' investor who neither contributes labor to the corporation nor takes part in management responsibilities. A shareholder in a public corporation simply invests money and hopes to receive a return on that money through capital appreciation and/or dividend payments."); Exadaktilos v. Cinnaminson Realty Co., 400 A.2d 554, 560 (N.J. Super. Ct. Law Div. 1979) ("Large corporations are usually formed as a means of attracting capital through the sale of stock to investors, with no expectation of participation in corporate management or employment. Profit is expected through the payment of dividends or sale of stock at an appreciated value.").

significant opportunity for abuse of an individual minority shareholder. Furthermore, shareholders of public companies are also protected by a web of regulations requiring disclosure and financial controls imposed by state and federal law and by the stock exchanges on which the shares are traded. However, the vast majority of corporations in this country are not large public organizations, but are so-called "closely-held corporations," which are largely unregulated, and in which the dynamics of management–owner interaction are very different.[33]

There are three practical differences between being a shareholder in a public corporation and in a closely-held corporation. First, as a much smaller enterprise, a closely-held corporation is much less likely to be able to afford independent, professional management and is much more likely to be operated and managed by some or all of its owners. [34] This situation creates inherent conflicts of interest among individual shareholders to a far greater extent than in a public corporation. In a closely-held corporation, those stockholders acting as officers and directors would be in a position to manage the enterprise so as to obtain a disproportionate share of the benefits of ownership, to the detriment of the other shareholders.[35] Also, the fact that the shareholders are operating the business means that closely-held corporations may distribute profits as wages in addition to or instead of dividends. Second, public corporations with a large and diverse population of shareholders rarely have a shareholder in a position of majority control. The opposite is true for closely-held corporations. Again, the presence of majority control creates the opportunity and temptation to use that control to obtain a disproportionate share of the benefits of ownership. Finally, and most importantly, there is no public market for the shares of a closely-held corporation. Regardless of how valuable an ownership interest in a closely-held corporation might be in the abstract, a minority shareholder is not able to sell it, generally at all, and certainly not at anything approaching its full value. This situation means that capital appreciation is rarely an investment objective of a shareholder in a closely-held corporation, as there is no way to monetize it.[36] A sale of the entire company can happen, but that scenario is generally a long time off and cannot be counted on by a minority shareholder as an exit strategy. A shareholder in a public corporation, however, can cash in on capital appreciation at any time by selling in the public markets and can also cut his losses and walk away from the investment if he becomes dissatisfied with management.[37] A minority shareholder in a closely-held corporation is trapped if the

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[33] Moll, *Shareholder Oppression in Texas*, *supra* note 25 ("Conventional corporate law norms of majority rule and centralized control can lead to serious problems for the close corporation minority shareholder.").

[34] *Id.* at 34–35 ("A shareholder in a public corporation simply invests money and hopes to receive a return on that money through capital appreciation and/or dividend payments. By contrast, in a close corporation, a shareholder typically expects an active participatory role in the company, usually through employment and a meaningful role in management."). *See also* Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 512 (Mass. 1975) ("Many close corporations are really partnerships, between two or three people who contribute their capital, skills, experience and labor.").

[35] *See* TEX. PRAC.: BUS. ORGS., *supra* note 7, at § 30:2 ("In a public corporation, there is always a danger that directors will act to benefit themselves at the expense of shareholders generally. In a close corporation, the danger is that a majority shareholder or group will act to benefit themselves at the expense of minority shareholders.").

[36] Moll, *Shareholder Oppression in Texas*, *supra* note 25, at 35 ("A shareholder in a close corporation also invests money in the venture and, like all shareholders, he hopes to receive a return on that money. Because there is no active market for the company's shares, however, any financial return is normally provided by employment compensation and dividends, rather than by sales of stock at an appreciated value.").

[37] *Id.* at 38 ("In a public corporation, a minority shareholder can escape abusive majority conduct by selling his shares into the market and by correspondingly recovering the value of his investment. This ability to liquidate provides

shareholders in control of the company succumb to the temptation to take his share of the profits, to deny him a voice, to ignore his requests for information, or to effectively (or actually) render him a non-owner.[38] Conduct by the majority aimed at rendering a fellow shareholder effectively a non-owner might or might not be coupled with an effort to purchase his shares at a fraction of his proportional share of the value of the enterprise. This injury to the minority shareholder in a closely-held corporation, involving the loss or impairment or some or all of the privileges and benefits of owning a company, is what has been termed in modern jurisprudence as "shareholder oppression."

### C. Oppressive Conduct in Closely-Held Corporations

> A wielding of this power by any group controlling a corporation may serve to destroy a stockholder's vital interests and expectations. As the stock of closely-held corporations generally is not readily salable, a minority shareholder at odds with management policies may be without either a voice in protecting his or her interests or any reasonable means of withdrawing his or her investment.[39]

The corporation is ultimately subject to the control of the owner(s) of a majority of its shares; therefore, any person, family, or group of individuals controlling the majority of the shares, as a practical matter, exercises total power over the corporation. These majority shareholders almost always vote themselves and persons strongly aligned with them to all or most of the positions on the board of directors.[40] In closely-held corporations, where the number of shares and shareholders is small, the existence of a single person or a small, strongly aligned group of persons, owning or controlling a majority of the shares is the norm. Minority shareholders in these corporations are not able to elect officers or directors to protect their interests, and they are not able to prevail on any matter submitted to a vote of the shareholders, and thus have only that amount of influence over the corporation which the majority permits.

Because of the close involvement and personal relationships among the small groups of shareholders of closely-held corporations,[41] the opportunities are greatly increased for interpersonal conflict to arise among the shareholders or between management and particular shareholders. As the Supreme Court noted in *Ritchie v. Rupe*: "Occasionally, things don't work out as planned: shareholders die, businesses struggle, relationships change, and disputes arise. When, as in this case, there is no shareholders' agreement, minority shareholders who lack both contractual rights and voting power may have no control over how those disputes are resolved."[42] Because of the absence of a market in which to sell the shares, these shareholders are "locked-in" and vulnerable to a variety of types of misconduct designed to "squeeze" them

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some protection to investors in public corporations from the conduct of those in control.").

[38] *Id.* at 38–39 ("In a close corporation, however, the minority shareholder's investment is effectively trapped, as there is no ready market for the stock of a close corporation. Thus, close corporation shareholders can be 'locked-in' to the company, yet 'frozen-out' from any business returns.").

[39] Matter of Kemp & Beatley, Inc., 473 N.E.2d 1173, 1179 (N.Y. 1984).

[40] *See* Douglas Moll, *Majority Rule Isn't What It Used To Be: Shareholder Oppression in Texas Close Corporations*, 63 TEX. B.J. 434, 436 & n.4 (2000).

[41] *Id.* at 436.

[42] Ritchie v. Rupe, 443 S.W.3d 856, 878–79 (Tex. 2014).

out (that is, to force them to sell at an unfairly low price) or to "freeze" them out (that is, to render their share ownership meaningless).[43]

Minority shareholders may protect themselves contractually. "Shareholders of closely-held corporations may address and resolve such difficulties by entering into shareholder agreements that contain buy-sell, first refusal, or redemption provisions that reflect their mutual expectations and agreements."[44] Such agreements may define respective management and voting powers, the apportionment of losses and profits, the payment of dividends, and shareholders' rights to buy or sell shares from or to each other, the corporation, or an outside party.[45] However, shareholder agreements are relatively rare, and truly fair and comprehensive ones that solve future problems not anticipated at the founding of the company are rarer still. The dissenting opinion in *Ritchie* aptly noted: "[f]rom a relational standpoint, people enter closely-held businesses in the same manner as they enter marriage: optimistically and ill-prepared."[46] Owners of closely-held corporations are frequently linked by family or personal relationships, usually trust each other, and often regard such contractual protection as unnecessary.[47]

Controlling shareholders are in a position to abuse their power over minority shareholders by reducing or eliminating any economic benefits of ownership to the minority, by systematically violating the rights associated with share ownership, and otherwise by defeating the normal expectations of shareholders relating to the ownership of their shares. This conduct takes many forms and appears in many different factual situations. When times are good and the corporation is growing, the majority may act to appropriate a greater portion of the economic benefits to themselves at the minority's expense. When times are bad, the majority may act to preserve for themselves a greater piece of the shrinking pie at the expense of the minority. At any time, the majority may wish to get rid of minority ownership positions. The actions of the majority may be motivated by greed or by a perception (valid or not) that the minority owner is not contributing. Often, the motivation for oppressive conduct stems from personal conflict among the majority and minority shareholders.

Such oppressive conduct may act to "squeeze out"[48] a minority shareholder, forcing that shareholder to leave the corporation and sell his shares usually at an unfairly low price, or to "freeze out"[49] the minority shareholder by structuring corporate governance and distribution of economic benefits so as to render the minority shareholder's ownership essentially irrelevant. In either a freeze-out scenario or a squeeze-out attempt, the majority typically cuts off the minority shareholders from information about the corporation and from any participation in management. The majority will frequently manipulate the finances of the corporation so that profits are not distributed as dividends but rather are diverted to the majority through excessive

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[43] *See* Moll, *Shareholder Oppression in Texas*, *supra* note 25, at 36.

[44] *Ritchie*, 443 S.W.3d at 871.

[45] *Id.* at 878.

[46] *Id.* at 894 (Guzman, J., dissenting) (quoting Charles W. Murdock, *The Evolution of Effective Remedies for Minority Shareholders and Its Impact Upon Valuation of Minority Shares*, 65 NOTRE DAME L. REV. 425, 426 (1990)).

[47] Douglas K. Moll, *Minority Oppression & the Limited Liability Company: Learning (or Not) from Close Corporation History*, 40 WAKE FOREST L. REV. 883, 912 (2005).

[48] *Ritchie*, 443 S.W.3d at 894 (Guzman, J., dissenting).

[49] *Id.*

salaries, bonuses, or other personal benefits. When all of the shareholders work in the corporation and all corporate profits are paid out as salary and personal benefits, the majority will often terminate the minority shareholder's employment (and thus cut off all economic benefits from stock ownership).[50] The Supreme Court acknowledged that minority shareholders in closely-held corporations have no statutory right to exit the venture and receive a return of capital like partners in a partnership do, and usually have no ability to sell their shares like shareholders in a publicly-held corporation do; thus, if they fail to contract for shareholder rights in advance of difficulties, they will be uniquely vulnerable to potential abuse by a controlling shareholder or group.[51] "Unhappy with the situation and unable to change it, [minority shareholders] are often unable to extract themselves from the business relationship, at least without financial loss."[52]

Without legal protection, minority share ownership in a closely-held corporation can become essentially a joke—in other words: "There are 51 shares . . . . . that are worth $250,000. There are 49 shares that are not worth a ____."[53] The Texas Supreme Court acknowledged: "Closely-held corporations have unique attributes that may justify different protections under the law."[54] Prior to *Ritchie*, Texas courts had come to recognize that they must "take an especially broad view of the application of oppressive conduct to a closely-held corporation, where oppression may more easily be found," and must use their equitable powers to protect the minority shareholders who find themselves on the receiving end of a "squeeze out" and do not have a ready market for their shares.[55] The majority opinion in *Ritchie* clearly acknowledged:

> Our review of the case law and other authorities also convinces us that it is both foreseeable and likely that some directors and majority shareholders of closely-held corporations will engage in such actions with a meaningful degree of frequency and that minority shareholders typically will suffer some injury as a result. Although the injury is usually merely economic in nature, it can be quite substantial from the minority shareholder's perspective, as it often completely undermines their sole or primary motivation for engaging with the business. We thus conclude that the foreseeability, likelihood, and magnitude of harm sustained by minority shareholders due to the abuse of power by those in control of a closely-held corporation is significant, and Texas law should ensure that remedies exist to appropriately address such harm when the underlying actions are wrongful.[56]

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[50] *See generally* Moll, *Shareholder Oppression in Texas*, *supra* note 25, at 35–39 (distinguishing minority shareholder status in close corporation from publicly held corporation).

[51] *Ritchie*, 443 S.W.3d at 879.

[52] *Id.*

[53] Humphrys v. Winous Co., 133 N.E.2d 780, 783 (Ohio 1956).

[54] *Ritchie*, 443 S.W.3d at 864 n.8.

[55] Davis v. Sheerin, 754 S.W.2d 375, 381 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

[56] *Ritchie*, 443 S.W.3d at 879.

## III. RISE AND FALL OF THE SHAREHOLDER OPPRESSION DOCTRINE

### A. The Shareholder Oppression Doctrine—R.I.P.

#### *1. The "Oppression Statute"*

The term "oppression" in recent Texas case law was imported from the statute providing for the appointment of a receiver for rehabilitation of corporations, now codified at Section 11.404(a)(1)(C) of the Texas Business Organizations Code,[57] which permits a district court to appoint a receiver at the request of an individual shareholder upon a showing that "the actions of the governing persons of the entity are illegal, oppressive or fraudulent."[58] Prior to *Ritchie*, very little case law existed interpreting this statute.

#### *2. Advent of a New Legal Theory*

In the 1980s, Texas courts began drawing on case law and statutory developments in other jurisdictions to fashion a new cause of action for "shareholder oppression."[59] Prior to *Ritchie*, the Texas Supreme Court never ruled on the existence of the cause of action, but ten of the fourteen Texas courts of appeals recognized shareholder oppression as an independent cause of action and none held to the contrary.[60] In *Willis v. Donnelly*, the Texas Supreme Court had

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[57] The dissenting opinion in *Ritchie* repeatedly refers to Texas Business Organizations Code Section 11.404 as the "Oppression Statute." *See id.* at 893, 897–98 (Guzman, J., dissenting). The majority correctly takes the dissent to task for this characterization of the receivership provision: "We note that what the dissent calls 'the oppression statute,' the Legislature refers to as a rehabilitative receivership statute, only one prong of which includes oppression as one of three types of conduct addressed in that prong." *Id.* at 889 n.57.

[58] TEX. BUS. ORGS. CODE ANN. § 11.404(a)(1)(C) (West 2011).

[59] This article attempts only a brief survey of the development of the shareholder oppression doctrine in Texas, focusing primarily on the first and last significant appellate opinions and the *Ritchie* decision. For a much deeper historical analysis, see Bittle & Hinson, *supra* note 7, at 351–86.

[60] First Court of Appeals, Houston: Boehringer v. Konkel, 404 S.W.3d 18 (Tex. App.—Houston [1st Dist.] 2013, no pet.); Allen v. Devon Energy Holdings, L.L.C., 367 S.W.3d 355 (Tex. App.—Houston [1st Dist.] 2012, pet. granted, judgm't vacated w.r.m.); Joseph v. Koshy, No. 01-98-01432-CV, 2000 WL 124685, at *4 (Tex. App.—Houston [1st Dist.] Feb. 3, 2000, no pet.) (mem. op., not designated for publication); Willis v. Bydalek, 997 S.W.2d 798, 801 (Tex. App.—Houston [1st Dist.] 1999, pet. denied); Advance Marine, Inc. v. Kelley, No. 01-90-00645-CV, 1991 WL 114463, at *2 (Tex. App.—Houston [1st Dist.] June 27, 1991, no pet.) (mem. op., not designated for publication); Davis v. Sheerin, 754 S.W.2d 375, 383 (Tex. App.—Houston [1st Dist] 1988, writ denied).

Second Court of Appeals, Fort Worth: Cotten v. Weatherford Bancshares, Inc., 187 S.W.3d 687 (Tex. App.—Fort Worth 2006, pet. denied); Duncan v. Lichtenberger, 671 S.W.2d 948 (Tex. App.—Fort Worth 1984, writ ref'd n.r.e.).

Fourth Court of Appeals, San Antonio: Chapa v. Chapa, No. 04-12-00519-CV, 2012 WL 6728242, at *5 (Tex. App.—San Antonio Dec. 28, 2012, no pet.) (holding that appointment of a receiver was proper in a shareholder oppression case); Guerra v. Guerra, No. 04-10-00271-CV, 2011 WL 3715051, at *6 (Tex. App.—San Antonio Aug. 24, 2011, no pet.) (mem. op).

Fifth Court of Appeals, Dallas: ARGO Data Res. Corp. v. Shagrithaya, 380 S.W.3d 249 (Tex. App.—Dallas 2012, pet. filed); Cardiac Perfusion Servs., Inc. v. Hughes, 380 S.W.3d 198 (Tex. App.—Dallas 2012, pet. denied); Ritchie v. Rupe 339 S.W.3d 275, 285 (Tex. App.—Dallas 2011), *rev'd*, 443 S.W.3d 856.

Sixth Court of Appeals, Texarkana: Pinnacle Data Servs., Inc. v. Gillen, 104 S.W.3d 188, 192 (Tex. App.—Texarkana 2003, no pet.).

Seventh Court of Appeals, Amarillo: *In re* Trockman, No. 07-11-0364-CV, 2011 WL 554999 (Tex. App.—Amarillo

assumed "without deciding" that such a cause of action existed.[61] These cases applied a new cause of action and a new equitable remedy to situations in which a majority shareholder uses his power over the corporation to the significant disadvantage of a minority shareholder. For purposes of illustration, we will examine the first and last significant decisions rendered under the shareholder oppression doctrine.

### ***(a)*** *Davis v. Sheerin*

The Houston case of *Davis v. Sheerin*[62] was the first Texas case to recognize and attempt a systematic formulation of a shareholder oppression cause of action. This opinion was acknowledged by the Supreme Court as the "seminal" Texas authority on shareholder oppression.[63] One commentator has praised the *Davis* case as not only significant in Texas jurisprudence, but also as both influencing case law development in a number of other states[64] and as having "earned a prime place in black-letter corporations law."[65]

#### (1) Facts

In *Davis v. Sheerin*, a Texas corporation, W.H. Davis Co., was formed in 1955 and was owned by two shareholders, William Davis, 55%, and James Sheerin, 45%.[66] Both Davis and Sheerin, together with Davis's wife Catherine, were directors and officers; however, Davis was the president and managed the day-to-day running of the company, while Sheerin was involved as an investor only and did not work in the company. In 1985, Sheerin sued William and Catherine Davis claiming shareholder oppression. Sheerin sued both in his individual capacity

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Feb. 21, 2012, orig. proceeding) (mem. op.).

Eighth Court of Appeals, El Paso: Gonzalez v. Greyhound Lines, Inc., 181 S.W.3d 386, 392 n.5 (Tex. App.—El Paso 2005, no pet.).

Twelfth Court of Appeals, Tyler: Redmon v. Griffith, 202 S.W.3d 225 (Tex. App.—Tyler 2006, pet. denied).

Thirteenth Court of Appeals, Corpus Christi-Edinburg: Gibney v. Culver, No. 13-06-112-CV, 2008 WL 1822767 (Tex. App.—Corpus Christi April 24, 2008, pet. denied) (mem. op.); DeBord v. Circle Y of Yoakum, Inc., 951 S.W.2d 127, 133 (Tex. App.—Corpus Christi 1997), *rev'd on other grounds sub nom.*, Stary v. DeBord, 967 S.W.2d 352 (Tex. 1998).

Fourteenth Court of Appeals, Houston: Willis v. Donnelly, 118 S.W.3d 10, 34 (Tex. App.—Houston [14th Dist.] 2003), *rev'd on other grounds*, 199 S.W.3d 262 (Tex. 2006); Allchin v. Chemic, Inc., No. 14-01-00433-CV, 2002 WL 1608616, at *7 (Tex. App.—Houston [14th Dist.] July 18, 2002, no pet.) (mem. op., not designated for publication); Christians v. Stafford, No. 14-99-00038-CV, 2000 WL 1591000, at *2 (Tex. App.—Houston [14th Dist.] Oct. 26, 2000, no pet.) (mem. op., not designated for publication); Hoggett v. Brown, 971 S.W.2d 472, 488 n.13 (Tex. App.—Houston [14th Dist.] 1997, pet. denied); Alexander v. Sturkie, 909 S.W.2d 166, 170 n.2 (Tex. App.—Houston [14th Dist.] 1995, writ denied).

[61] *Willis*, 199 S.W.3d at 277.

[62] *Davis*, 754 S.W.2d 375.

[63] *Ritchie*, 443 S.W.3d at 865.

[64] *See* Dawson, *supra* note 7, at 89 (citing Baur v. Baur Farms, Inc., 780 N.W.2d 249 (Iowa Ct. App. 2010); Bedore v. Familian, 125 P.3d 1168, 1172 n.20 (Nev. 2006); Lien v. Lien, 2004 S.D. 8, ¶ 30, 674 N.W.2d 816, 825 (S.D. 2004)).

[65] *Id.* (citing ROBERT W. HAMILTON & JONATHAN R. MACEY, CASES AND MATERIALS ON CORPORATIONS, INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES, 500–07 (9th ed. 2005)).

[66] *Davis*, 754 S.W.2d at 377.

and derivatively on behalf of the corporation[67]—although the appellate opinion does not indicate that the corporation was a party.[68] The suit was filed initially because Davis refused to allow Sheerin to inspect the books and records of the corporation, claiming that Sheerin was not a shareholder.[69]

Davis claimed that Sheerin had relinquished his stockholdings in the 1960s as a gift to the Davises and refused to allow Sheerin to inspect corporate books unless he could produce a share certificate.[70] The jury found that Sheerin did not make a gift of his stock to Davis and his wife, did not represent that he would do so, and did not agree to do so in the future.[71] Additionally, the appellate court noted other undisputed evidence that the records of the corporation and tax returns continued to list Sheerin as a 45% shareholder well after the date of the alleged gift and that Davis and his son had made several attempts to purchase Sheerin's shares during the 1970s and '80s.[72] The jury found (1) that Davis and his wife had conspired to deprive Sheerin of his stock ownership in the corporation; (2) that Davis and his wife willfully breached fiduciary duties to the corporation by receiving "informal dividends" through contributions to a profit sharing plan for their benefit and to the exclusion of Sheerin; (3) that Davis and his wife willfully breached fiduciary duties by "wast[ing] corporate funds for payment of their legal fees in the dispute"; however the jury also found (4) that Davis and his wife did not convert Sheerin's stock; (5) that Davis and his wife were not paid excessive compensation; (6) that Davis and his wife did not maliciously suppress dividends; (7) that Davis and his wife did not breach fiduciary duties by having the corporation make a variety of purchases and investments that Sheerin argued were improper; and (8) that Davis and his wife did not conspire to breach fiduciary duties.[73] The jury also found that the conspiracy to deprive Sheerin of his share ownership was not a proximate cause of any damages.[74] Finally, the jury found that the "fair value" of Sheerin's stock was $550,000.[75] Furthermore, the appellate court noted as significant the undisputed facts that the corporation's attorney had written in 1979 that Davis' wish to avoid payment of dividends might be characterized as a fraudulent effort to

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[67] *Id.*

[68] Ordinarily, the corporation is a necessary party to a derivative suit. *See* Barthold v. Thomas, 210 S.W. 506, 507–08 (Tex. Comm'n App.1919, holding approved, judgm't adopted); Providential Inv. Corp. v. Dibrell, 320 S.W.2d 415, 418 (Tex. Civ. App.—Houston 1959, no writ). *See also* Ross v. Bernhard, 396 U.S. 531, 538 (1970) ("A corporation is a necessary party in a derivative suit. The corporation is a necessary party to the action; without it the case cannot proceed.").

[69] *Davis*, 754 S.W.2d at 377. The lawsuit also involved claims arising from a separate real estate partnership, but those claims are not relevant to this discussion.

[70] *Id.* The appellate opinion does not give any further explanation. Presumably, Davis knew that Sheerin could not produce a share certificate proving his share ownership. Given Davis's theory of the case, the intended inference is that Sheerin gave Davis the share certificate in the 1960s when he allegedly made a gift of his ownership interest. However, if that were the case, one would expect that the endorsed share certificate would have been a key piece of evidence relied on by Davis at trial and would have warranted further comment in the opinion. More likely, Davis knew Sheerin could not produce a share certificate because no certificates had ever been issued, which is the almost universal practice in small, informally-organized corporations—and which makes Davis's demand for a share certificate all the more evidence of his bad faith.

[71] *Id.* at 382.

[72] *Id.*

[73] *Id.*

[74] *Id.* at 381.

[75] *Id.* at 378. Sheerin did not challenge this finding on appeal. *Id.* at 383.

deny a shareholder his dividends and that, shortly after the filing of the lawsuit, Davis and his wife held a meeting of the board of directors at which they noted in the minutes that "Mr. Sheerin's opinions or actions would have no effect on the Board's deliberations."[76]

On the basis of these findings and the undisputed portions of the evidence, the Houston trial court entered a judgment that included the following relief: [77] (1) a declaratory judgment that Sheerin owned 45% of the stock in the corporation; (2) an order that Davis and his wife "buy out" Sheerin's stock for the "fair value" of $550,000, as determined by the jury; (3) the appointment of a receiver for the corporation;[78] (4) an injunction against contributions to the profit sharing plan unless a proportionate sum was paid to Sheerin; (5) a mandatory injunction for payment of dividends in the future; (6) award of damages to Sheerin individually for the informal dividends paid in the past by profit sharing contributions; (7) an award of costs incurred by Sheerin in enforcing his inspection rights ; and (8) an award of damages to Sheerin, on behalf of the corporation, for the amount the corporation paid for Davis' attorney's fees.[79]

**(2)** Holdings

On appeal, Davis challenged the buy-out order, the appointment of the receiver, and the order to pay dividends, but did not challenge the declaration of share ownership or the valuation.[80] The First Court of Appeals affirmed the buy-out order,[81] and the appointment of a receiver,[82] but reversed the mandatory injunction to pay dividends.[83]

The principal issue on appeal was whether the buy-out remedy was available under Texas law. The plaintiff contended that the defendants should be ordered to purchase the plaintiff's shares because the defendants had committed "oppression" against the plaintiff. At the time, Article 7.05(a)(1)(c) of the Texas Business Corporation Act (now Texas Business Organizations Code § 11.404(a)(1)(C)) provided that a court may appoint a receiver for the

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[76] *Id.* at 382.

[77] *Id.* at 378.

[78] The appointment of the receiver, the injunction against future preferential dividends, and the mandatory injunction for the future payment of dividends are all seemingly at odds with the buy-out order. If Sheerin is going to be bought out, then the receiver would be unnecessary and the other relief would be meaningless. The court of appeals assumes that these portions of the judgment would apply only until "the 'buy-out' was completed and the damages paid." *Id.* at 384. "We further note that appellants may avoid the necessity of the appointment of the receiver by immediate compliance with the court's 'buy-out' order and payment of the damages awarded." *Id. See also id*. (same reasoning with respect to the injunction against preferential informal dividends "as long as plaintiff remains a shareholder"); *id.* at 388 (Evans, J., concurring) (reasoning that the mandatory injunction on payment of dividends would be "as long as the appellee remains a shareholder").

[79] The award of attorney's fees is somewhat unclear. The court of appeals' opinion states that Sheerin received "an award of $192,600 to appellee, on behalf of the corporation, for recovery of corporate funds used for appellants' attorney's fees." *Id.* at 378. This award was clearly on Sheerin's derivative claim, and presumably the $192,600 is 45% of the gross amount misappropriated to which Sheerin would be entitled to receive as his proportionate share of the derivative claim.

[80] *Id.* at 378.

[81] *Id.* at 383.

[82] *Id.* at 384.

[83] *Id.* at 385.

assets and business of a corporation to conserve the assets and avoid damage to the parties (also to conduct an orderly liquidation under article 7.06), "but only if all other requirements of law are complied with and if all other remedies available either at law or in equity . . . are determined by the court to be inadequate and only in [certain specific] instances," one of which is an action by a shareholder establishing "that the acts of the directors or those in control of the corporation are illegal, oppressive, or fraudulent."

The First Court of Appeals noted that "oppressive" conduct is prohibited by Article 7.05(a)(1)(c) of the Texas Business Corporations Act, but that the only statutory remedy was the appointment of a receiver.[84] The court also noted that no Texas case had ever ordered the remedy of a "buy-out," but the court reasoned, based on authority in other jurisdictions[85] and on the holding of the Texas Supreme Court in *Patton v. Nicholas*[86] that the court had the inherent equitable power to fashion a remedy for oppressive conduct, other than receivership or liquidation.[87] Therefore, court held that "Texas courts, under their general equity power, may decree a 'buy-out' in an appropriate case where less harsh remedies are inadequate to protect the rights of the parties."[88]

Next the court discussed what constituted oppressive conduct. The court noted that neither Texas statutory nor common law provided a definition of "oppression."[89] Therefore, the court examined authority from other jurisdictions and adopted two different (but complimentary) definitions: First, "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,"[90] and second, "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."[91]

The court held that the record clearly substantiated a finding of oppression, notwithstanding "the absence of some of the typical 'squeeze out' techniques used in closely-

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[84] *Id.* at 378.

[85] *Id.* at 379 (citing Alaska Plastics, Inc. v. Coppock, 621 P.2d 270, 276–77 (Alaska 1980); Sauer v. Moffitt, 363 N.W.2d 269, 275 (Iowa Ct. App. 1984); McCauley v. Tom McCauley & Son, Inc., 724 P.2d 232, 244 (N.M. Ct. App.1986) (granting the option of liquidation or "buy-out"); *In re* Wiedy's Furniture Clearance Center Co., 487 N.Y.S.2d 901, 904 (N.Y. App. Div. 1985); Delaney v. Georgia-Pacific Corp., 564 P.2d 277, 289 (Or. 1977)). The *Davis* Court also looked to statutes providing for a buy-out remedy. *Id.* (citing ALASKA STAT. § 10.05.540(2) (1985); CAL. CORP. CODE § 2000 (West Supp.1988); CONN. GEN. STAT. ANN § 33-384 (West 1987); ILL. REV. STAT. ch. 32, para. 12.55 (Supp. 1988); IOWA CODE § 496A.94 (Supp. 1988); MINN. STAT. ANN. § 302A.751 (West 1985); N.M. STAT. ANN. § 53-16-16 (West Supp. 1987); N.Y. BUS. CORP. LAW § 1104-a (McKinney 1986); N.C. GEN. STAT. § 55-125.1 (1982); OR. REV. STAT. § 57.595 (1983); S.C. CODE ANN. § 33-21-155 (1987); W. VA. CODE § 31-1-134 (1988)).

[86] 279 S.W.2d 848, 857 (Tex. 1955).

[87] *Davis*, 754 S.W.2d at 379.

[88] *Id.* at 380.

[89] *Id.* at 381.

[90] *Id.* (citing *In re Wiedy's*, 487 N.Y.S.2d at 903).

[91] *Id.* at 382 (citing Baker v. Com. Body Builders, Inc., 507 P.2d 387 (Ore. 1973)).

held corporations, e.g., no malicious suppression of dividends or excessive salaries."[92] The *Davis* court stated that "conspiring to deprive one of his ownership of stock in a corporation, especially when the corporate records clearly indicate such ownership . . . not only would substantially defeat any reasonable expectations appellee may have had, . . . but would totally extinguish any such expectations."[93] Significantly, the court held that the oppressive conduct need not be the proximate cause of any damages,[94] and that oppressive conduct did not fall under the protection of the business judgment rule.[95]

**(3)** Defining the shareholder oppression cause of action

The court of appeals' opinion in *Davis v. Sheerin* did a remarkably good job in defining a new cause of action for shareholder oppression. The duty violated was purely statutory and arose from the prohibition in article 7.05(a)(1)(c) of the Texas Business Corporations Act[96] against "oppressive" acts by "directors or those in control of the corporation."[97] This was a duty owed by the controlling shareholder directly to the minority shareholder, and a claim for violation of that duty was a claim brought directly by the shareholder in his individual capacity. In order to prove a violation of the duty not to act oppressively, the shareholder was required to prove acts that either (1) "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,"[98] or (2) are "'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 an violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.'"[99] These alternative definitions were meant to be "expansive" and "to cover a multitude of situations dealing with improper conduct."[100] "Oppressive" conduct included denial of share ownership, the denial of a voice in corporate affairs, and willful breaches of fiduciary duties to the corporation,[101] together with more "typical 'squeeze-out' techniques used in closely -held corporations, e.g., [. . .] malicious suppression of dividends or excessive salaries."[102] The existence of oppressive acts was a jury question,[103] but whether those acts constituted a violation of the duty not to oppress was a question of law for the court, and no jury question on oppression was to be submitted.[104]

The remedy for violation of the duty was either appointment of a receiver pursuant to the

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92 *Id.* at 382–83.

93 *Id.* at 382.

94 *Id.* at 381.

95 *Id.* at 383.

96 TEX. BUS. ORGS. CODE ANN. § 11.404(a)(1)(C) (West 2011).

97 *Davis*, 754 S.W.2d at 381 (Article 7.05 of the Texas Business Corporations Act "provides a cause of action based on oppressive conduct").

98 *Id.*

99 *Id.* at 382.

100 *Id.* at 381.

101 *Id.* at 383

102 *Id.* at 382.

103 *Id.* at 380.

104 *Id.* at 381.

statute or a lesser equitable remedy crafted by the court, which could include an order that the majority shareholder purchase the minority shareholder's stock at "fair value" or injunctive relief addressing specific conduct, such as injunctions prohibiting the payment of disproportionate "informal" dividends or requiring the payment of dividends.[105] The decision to award equitable relief was made by the court and subject to review for abuse of discretion.[106] A buy-out order was justified where the plaintiff proved (1) that the oppressive conduct constituted a pattern of such conduct likely to "continue in the future,"[107] and (2) that other relief was not adequate.[108] The price paid in the buy-out was "fair value" of the stock and was determined by the jury.[109] A claim for shareholder oppression could be brought with other claims, including derivative claims, dividend claims, and claims for violation of statutory inspection rights.

The *Davis* court's treatment of the new shareholder oppression cause of action was clarified in the next oppression case decided in Texas, which also came out of the First Court of Appeals, *Willis v. Bydalek*.[110] The court of appeals reversed a shareholder oppression judgment for the plaintiff, holding that the sole act of oppressive conduct that the jury found, "wrongful lock out," was no more than the firing of an at-will employee.[111] The court of appeals did not hold that "firing an at-will employee who is a minority shareholder could never, under any circumstances, constitute oppression," but only that under the circumstances of this case the sole act of firing an at-will employee could not constitute shareholder oppression.[112] The court emphasized that only one act of oppressive conduct was proven and that a pattern of oppressive conduct was an important element in establishing oppression. The court also made clear that the finding of oppression must take into consideration other legal concepts, such as the business judgment rule and at-will employment, and was not an exception to those other doctrines.

### ***(b)*** *Boehringer v. Konkel*

*Boehringer v. Konkel*[113] was the last significant shareholder oppression case to be decided

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[105] *Id.* at 383.

[106] *Id.* at 380.

[107] *Id.* at 383. The bad faith or malicious intent of the majority shareholder was significant on this element.

[108] *Id.* at 380 ("We conclude that Texas courts, under their general equity power, may decree a 'buy-out' in an appropriate case where less harsh remedies are inadequate to protect the rights of the parties."); *id.* at 383 ("However, based on appellants' conduct denying appellee any interest or voice in the corporation, we find that these remedies are inadequate to protect appellee's interest and his rights in the corporation.").

[109] *Id.* at 384. Because Davis did not appeal the jury's finding of "fair value," the court of appeals did not discuss the meaning or elements of that concept. However, it is reasonable to assume that the court intended to use the term consistently with its meaning when a shareholder is bought out as a result of exercising a right to dissent. *See* TEX. BUS. ORGS. CODE ANN. § 10.362 (West 2015) ("In computing the fair value of an ownership interest under this subchapter, consideration must be given to the value of the domestic entity as a going concern without including in the computation of value any control premium, any minority ownership discount, or any discount for lack of marketability."). The definition of "fair value" in the jury charge is not stated in the appellate opinion.

[110] 997 S.W.2d 798 (Tex. App.—Houston [1st Dist.] 1999, pet. denied).

[111] *Id.* at 802.

[112] *Id.* 802–03.

[113] 404 S.W.3d 18 (Tex. App.—Houston [1st Dist.] 2013), *disapproved by*, Ritchie v. Rupe, 443 S.W.3d 856 (Tex. 2014).

prior to the publication of the Supreme Court's opinion in *Ritchie* was published.

Konkel and Boehringer were chemical engineers, and Konkel bought 49.9% of the stock in Boehringer's closely-held corporation, which designed industrial processes and machinery and equipment used in refineries, chemical plants, biofuel facilities, and pharmaceutical production facilities.[114] At the first shareholder meeting, both agreed that salaries would be set at $60,000 annually for both men and that Boehringer would act as president and Konkel as vice president.[115] "From 2001 to 2004, the company was a two-man operation," but beginning in 2005, the company grew substantially, acquiring office space, hiring employees, and earning significant revenues—growing to in excess of $1 million per year between 2005 and 2008, compared to 2004 sales of $550,000.[116] "Shortly after this marked success, the relationship between Konkel and Boehringer deteriorated," and "Konkel made between ten and twenty requests for corporate records from between 2001 and 2009," which Boehringer ignored.[117]

"The situation reached its boiling point at the February 2, 2009 shareholder meeting, when Boehringer" told "Konkel that he was "'going to make [Konkel's] fucking life miserable.'"[118] Following the meeting, "Boehringer sent a company-wide email stating that Konkel was no longer in management," and Konkel resigned shortly thereafter, stating that his only remaining connection to the corporation was as a shareholder.[119] "Later, Konkel learned that Boehringer had secretly awarded himself a pay raise in late 2008," increasing his gross pay to $240,000 annually, compared to Konkel's $48,000.[120] Despite earnings which generated a tax liability to Konkel for 2008, Boehringer never issued to Konkel dividends from the 2008 earnings.[121] On February 23, 2009, Konkel sued Boehringer for shareholder oppression.[122]

"The jury found that Boehringer had maliciously or wrongfully refused to allow Konkel to examine" corporate books, "used his position to award himself an excessive salary to Konkel's detriment," and wrongfully withheld dividends from Konkel in 2008.[123] The trial court held that "shareholder oppression occurred as a matter of law" and ordered that "the corporation be liquidated, with proceeds split according to share" ownership after all debts were subtracted.[124] Boehringer challenged legal and factual sufficiency of the evidence; the First Court of Appeals affirmed.[125]

The appellate court held: "The doctrine of shareholder oppression protects the close corporation minority stockholder from the improper exercise of majority control."[126] The

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114 *Id.* at 22.
115 *Id.*
116 *Id.* at 22–23.
117 *Id.* at 23.
118 *Id.*
119 *Id.*
120 *Id.*
121 *Id.* at 23–24.
122 *Id.* at 24.
123 *Id.*
124 *Id.*
125 *Id.* at 22.
126 *Id.* at 25 (citing Moll, *Majority Rule*, *supra* note 40).

Court cited the "two non-exclusive definitions of shareholder oppression":

> 1. majority shareholders' 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.[127]

On the specific factual findings, the court concluded that the jury could reasonably have found "that Boehringer maliciously or wrongfully refused to allow Konkel to examine" the books and records,[128] that Boehringer used his position as president of the corporation to award himself an excessive salary to Konkel's detriment,[129] and "that Boehringer withheld issuance of a dividend and used his two-fold pay increase as a means of denying Konkel his proportionate participation in the company's earnings."[130]

The court held that "[a]n expectation of annual compensation through employment cannot be said to be a general expectation held by all shareholders of a corporation,"[131] and that if Konkel were complaining about his own salary, he would be required "to provide proof of specific facts showing that his specific expectation of a certain level of compensation was reasonable under the circumstances and central to his decision" to invest; however, the court noted, "Konkel is not complaining about his own compensation, but that Boehringer's raising of his own salary was detrimental to Konkel."[132] The court further held that "[a]s a shareholder, Konkel had a general and reasonable expectation to have the right to proportionate participation in the earnings of the company," and that "the board resolution from the first shareholder meeting at which Konkel joined the company" proved his "reasonable expectation that corporate monetary benefits would be divided equally."[133] The court held that the evidence justified the finding that Boehringer had received "a de facto dividend to the exclusion of Konkel."[134]

### *3. The Shareholder Oppression Cause of Action*

By the time of the *Ritchie v. Rupe* decision, the shareholder oppression cause of action developed by the Texas courts of appeals may be summarized as follows: The shareholder oppression cause of action was an individual claim belonging to the shareholder personally and

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127 *Id.* (citing Willis v. Bydalek, 997 S.W.2d 798, 801 (Tex. App.—Houston [1st Dist.] 1999, pet. denied).

128 *Id.* at 28.

129 *Id.* at 30.

130 *Id.* at 31.

131 *Id.* at 29 (citing ARGO Data Res. Corp. v. Shagrithaya, 380 S.W.3d 249, 266 (Tex. App.—Dallas 2012, pet. denied)).

132 *Id.*

133 *Id.* at 30.

134 *Id.* at 31.

asserted in his individual capacity.[135] The duties were imposed on the controlling shareholder or directors not to oppress the minority shareholder. Oppressive conduct could be proven in one of two ways: either by proof that the minority's "reasonable expectations" had been substantially defeated or that the conduct was so bad as to constitute "burdensome, harsh, or wrongful conduct."[136] Reasonable expectations were "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."[137] A plaintiff could prove "specific reasonable expectations," which would be based on either an express agreement between minority shareholder and majority shareholder or one clearly implied by the facts and required "proof of specific facts giving rise to the expectations in a particular case and a showing that the expectation was reasonable under the circumstances of the case as well as central to the minority shareholder's decision to join the venture."[138] "General reasonable expectations" were reasonable as a matter of law, and were recognized by the courts as expectations that arise from stock ownership; these expectations are common to all stockholders and require no proof.[139] While every case paid lip service to "specific reasonable expectations," all the shareholder oppression cases really based their holdings on "general reasonable expectations." Early cases placed particular emphasis on the defendant's state of mind and required proof of a "pattern" of conduct likely to continue into the future. Later cases seem to have dispensed with the pattern requirement, with court of appeals in *Ritchie* affirming based on one bad act and the *Boehringer* court stating that any one of the bad acts proven would have been sufficient.[140] Finally, the determination of whether the defendant had committed oppression was made by the court, with the jury only asked whether the defendant committed the allegedly oppressive acts.

The cause of action was not without problems. Shareholder oppression had no elements, only "definitions." Other than to point to the use of the word "oppressive" in the receivership statute, no court ever identified the source of the duty or defined the nature of the duty. Case law provided absolutely no guidance as to how much oppressive conduct was enough. As the Supreme Court would note in *Ritchie*, the doctrine has been heavily criticized for its lack of clarity and predictability.[141] Courts were left to their own equitable judgment, subject only to review for abuse of discretion. Furthermore, oppressive conduct could be proven by self-dealing acts that were breaches of fiduciary duties to the corporation and not to the minority

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[135] Redmon v. Griffith, 202 S.W.3d 225, 234 (Tex. App.—Tyler 2006, pet. denied), *disapproved by*, Ritchie v. Rupe, 443 S.W.3d 856 (Tex. 2014).

[136] Boehringer v. Konkel, 404 S.W.3d 18, 25 (Tex. App.—Houston [1st Dist.] 2013, no pet.) (citing Willis v. Bydalek, 997 S.W.2d 798, 801 (Tex. App.—Houston [1st Dist.] 1999, pet. denied)).

[137] *Id.*

[138] *Id.* at 26.

[139] *Id.*

[140] *Id.* at 32–33.

[141] *See* Ritchie v. Rupe, 443 S.W.3d 856, 889–90 & n.60–61 (Tex. 2014) (citing Timothy J. Storm, *Remedies for Oppression of Non–Controlling Shareholders in Illinois Closely–Held Corporations: An Idea Whose Time Has Gone*, 33 LOY. U. CHI. L.J. 379, 383–84, 435 (2002); Sandra K. Miller, *How Should U.K. and U.S. Minority Shareholder Remedies for Unfairly Prejudicial or Oppressive Conduct Be Reformed?*, 36 AM. BUS. L.J. 579, 617 (1999); Hunter J. Brownlee, *The Shareholders' Agreement: A Contractual Alternative to Oppression As A Ground for Dissolution*, 24 STETSON L. REV. 267, 286 (1994)).

shareholder.[142] Absent the shareholder oppression doctrine, a shareholder could only obtain relief for such acts through a derivative action brought for the benefit of the corporation. The willingness of the courts to allow such self-dealing misconduct to be dealt with directly by the shareholder through the shareholder oppression doctrine threatened to make the entire body of law regarding derivative suits irrelevant.

Nevertheless, the shareholder doctrine became universally accepted in Texas appellate courts, none of whom ever questioned its difficulties or attempted to address them.

### *4. Buy-Out Remedy*

What gave the shareholder oppression doctrine its remedial teeth was the buy-out order. While the courts were free to fashion any appropriate remedy, almost all of them opted for a compulsory buy-out. The vulnerability of a minority shareholder to oppressive conduct (and the source of the temptation to the majority shareholder to engage in such conduct) was that the minority was "locked-in," trapped with no ability to cut his losses, cash out, and walk away. The buy-out remedy fixed what was broken about the legal structure of closely-held corporations. The remedy was incredibly practical and logical. As the court in *Davis* had written, "[a]ppellants' oppressive conduct, along with their attempts to purchase appellee's stock, are indications of their desire to gain total control of the corporation. That is exactly what a 'buy-out' will achieve."[143] In effect, the majority, through its oppressive conduct, had wrongfully taken the value of the minority's stock ownership. The shareholder oppression doctrine with its buy-out remedy merely forced the majority pay a fair price for what it had been wrongfully taken. In *Davis v. Sheerin*, the court held "An ordered 'buy-out' of stock at its fair value is an especially appropriate remedy in a closely-held corporation, where the oppressive acts of the majority are an attempt to 'squeeze out' the minority, who do not have a ready market for the corporation's shares, but are at the mercy of the majority."[144]

The typical measure of damages for loss of property, such as stock, would be fair market value. The problem with the notion of "fair market value" in the case of a minority interest in a closely-held corporation is that there is no market for the shares—and thus no way to determine a "market value."[145] Courts have generally acknowledged that the "true value" of a closely-held corporation is, at best, a subjective guess.[146] However, Texas shareholder oppression cases used the term "fair value" as opposed to "fair market value."

In the court of appeals' opinion in *Ritchie v. Rupe*, the Dallas Court of Appeals fully developed the law governing the buy-out remedy. After holding that "Texas law authorizes the trial court, in an appropriate case, to order a buyout of an oppressed minority shareholder as an equitable remedy for shareholder oppression,"[147] and rejecting the argument that the buy-out

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[142] *See* Redmon v. Griffith, 202 S.W.3d 225, 235 (Tex. App.—Tyler 2006, pet. denied); *In re* Trockman, No. 07-11-0364-CV, 2012 WL 554999, at *3 n.2 (Tex. App.—Amarillo Feb. 21, 2012, orig. proceeding) (mem. op.).

[143] Davis v. Sheerin, 754 S.W.2d 375, 383 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

[144] *Id.* at 381.

[145] *See* Ward v. Succession of Freeman, 854 F.2d 780, 783 n.1 (5th Cir. 1988); Sommers Drug Stores Co. Emp. Profit Sharing Trust v. Corrigan Enters., Inc., 793 F.2d 1456, 1462 (5th Cir.1986).

[146] *See* Kademian v. Ladish Co., 792 F.2d 614, 626 (7th Cir.1986).

[147] Ritchie v. Rupe, 339 S.W.3d 275, 289 (Tex. App.—Dallas 2011), *rev'd*, 443 S.W.3d 856 (Tex. 2014).

order was "so harsh as to constitute an abuse of discretion,"[148] the court dealt with mechanics of valuation. First, what is the valuation date? The court noted that the wrongful acts that were chiefly relevant to the claim occurred in February 2006, that the lawsuit was filed in July 2006, and that the plaintiff's expert's valuation was based on "last audited financial statements" dated as of June 30, 2006, and held that the trial court's use of June 30, 2006 was not an abuse of discretion.[149] This holding was consistent with the Fifth Circuit's holding in *Hollis v. Hill*, a Texas shareholder oppression case governed by Nevada law, that the "presumptive valuation date for other states allowing buy-out remedies is the date of filing unless exceptional circumstances exist which require an earlier or later date to be chosen."[150]

Next the court of appeals addressed the more difficult issue of applying minority discounts for lack of control and lack of marketability.[151] In most contexts, appraisers believe that a minority interest in a closely-held corporation is worth less than the minority percentage of the market value of the business as a whole.[152] The reason for this disparity in value is that no market exists for the minority shares, so that any buyer would be entirely dependent upon the declaration of dividends for a return on investment; and the purchaser, as a minority shareholder, would have no power to compel the distribution of dividends. Therefore, any purchaser of a minority interest would be given an incentive in the form of a discount to take these additional risks. The court of appeals held that there are two types of "fair value," enterprise value and fair market value, with "enterprise value" being "determined by the value of the company as a whole and ascribing to each share its pro rata portion of that overall enterprise value," and "fair market value" being defined as "the price at which the stock would change hands between a willing seller, under no compulsion to sell, and a willing buyer, under no compulsion to buy, with both parties having reasonable knowledge of relevant facts."[153] "Enterprise value does not include a discount based on the stock's minority status or lack of marketability," whereas "fair market value" of corporate stock does include those discounts.[154] The court held that, in most shareholder oppression cases, enterprise value "has been seen as the appropriate valuation when a minority shareholder, with no desire to leave the corporation, has been forced to relinquish his ownership position by the oppressive conduct of the majority."[155] However, in *Ritchie v. Rupe*, the oppressive conduct chiefly complained of was the interference with the plaintiff's ability to sell her minority interests to a third party; therefore, "[i]n crafting an equitable remedy for appellants' oppressive conduct in connection with [plaintiff's] efforts to sell the Stock, the trial court should have provided the relief prevented by appellants' conduct, i.e., a sale at fair market value."[156]

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148 *Id.* at 298–99.

149 *Id.*

150 Hollis v. Hill, 232 F.3d 460, 472 (5th Cir. 2000).

151 *Ritchie*, 339 S.W.3d at 300.

152 *See, e.g.*, SHANNON PRATT, VALUING A BUSINESS, 385 (5th ed. 2008) ("Control shares are normally more valuable than minority shares because they contain a bundle of rights that minority shares do not enjoy.").

153 *Ritchie*, 339 S.W.3d at 300.

154 *Id.*

155 *Id.* at 301.

156 *Id.*

### B. The Texas Supreme Court's Ruling in *Ritchie v. Rupe*

#### *1. The Court of Appeals' Opinion*

The Fifth Court of Appeals' 2011 opinion in *Ritchie v. Rupe* was the most detailed discourse and shareholder oppression up to that date, and also the most expansive of minority shareholder rights.[157] Since the First Court of Appeals first recognized the buy-out as a remedy for oppressive conduct in *Davis v. Sheerin* in 1988, the Texas Supreme Court had declined to express an opinion regarding the shareholder oppression cause of action.[158] Meanwhile, Texas courts of appeals continued ruling on shareholder oppression cases and had, over the intervening twenty-three years, created a significant body of jurisprudence on this subject. During that time, numerous petitions for review were filed to the Texas Supreme Court, and each time the Court denied those requests, but never refused review, which would have constituted an implicit recognition that the court of appeals' opinion is "correct and the legal principles announced in the opinion are likewise correct.[159] On March 2, 2012, the Texas Supreme Court granted Ritchie's Motion for Rehearing on the initial denial of his petition for review. Oral arguments were heard on February 26, 2013, and more than nine amicus curiae briefs were filed in the matter. What was so special about *Ritchie* that warranted the Court's attention after Ritchie's second petition for review?

In that case, Ann Caldwell Rupe became trustee of the Dallas Gordon Rupe III Family Trust after her husband's death.[160] The trust held an 18% interest in Rupe Investment Corporation (RIC).[161] Mrs. Rupe sought to market her interest to third parties, and hired a retired capital fund manager, George Stasen, to assist her. Stasen met with the RIC's other shareholders regarding the sale who informed him that no one from RIC management would meet with any potential buyers. The plaintiff contended that this refusal rendered Mrs. Rupe's interest essentially worthless, because, as Stasen testified, no buyer would purchase an interest in a closely-held corporation before speaking with corporate management.[162] Mrs. Rupe's shareholder oppression claim, as stated in the appellate opinion, centered on this act: managements' refusal to meet with potential buyers of her shares. At trial, the jury found for Mrs. Rupe, and the trial court concluded that the refusal constituted oppressive conduct and ordered that her shares be purchased for $7.3 million.[163]

Unlike earlier cases that had based the buy-out remedy on a series of bad acts that support the "the likelihood that [this oppressive conduct] would continue in the future,"[164] the *Ritchie* court of appeals' opinion did not address the issue of a pattern, but instead focused on the fact that, because Mrs. Rupe's shares were unrestricted, she had the general reasonable expectation

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157 339 S.W.3d 275.

158 In *Willis v. Donnelly*, the Texas Supreme Court found that because Donnelly never became a shareholder, the Willises could not have owed fiduciary duties to Donnelly. 199 S.W.3d 262, 278 (Tex. 2006).

159 TEX. R. APP. P. 56.1(c) (West 1997).

160 *Ritchie*, 339 S.W.3d at 282.

161 *Id.*

162 *Id.*

163 *Id.* at 281.

164 Davis v. Sheerin, 754 S.W.2d 375, 383 (Tex. App.—Houston [1st Dist.] 1988, writ denied), *disapproved by*, *Ritchie*, 443 S.W.3d 856.

to "sell her stock to a party of her choosing at a mutually acceptable price."[165] Any corporate policy prohibiting a shareholder from marketing shares to third parties defeats that general reasonable expectation. The court did say that shareholders do not have the expectation that controlling shareholders or directors would either market the shares on the minority's behalf or make any statements that would mislead potential investors.[166]

In their brief to the Texas Supreme Court, the petitioners argued that the "Texas shareholder oppression statute," which allows the appointment of a receiver based on "illegal, oppressive, or fraudulent"[167] conduct, should be the only remedy available.[168] Petitioners also asserted that the "reasonable expectations test" is a flawed test that is not appropriate under the current statute and is not appropriate when a shareholder "acquire[s] her shares in a preexisting corporation by way of inheritance."[169]

Respondents pointed out that the receivership statutes are measures of last resort, to be used only "if all other remedies available either at law or in equity . . . are determined by the court to be inadequate."[170] Respondents also pointed out that the "reasonable expectations test" is used in courts throughout the country to determine whether oppressive conduct has occurred. In addition, Respondents noted that the jury found that a relationship of trust and confidence existed and that Petitioners did not comply with their fiduciary duties arising from this relationship. A buy-out would be an appropriate remedy for the breach of fiduciary claim as well as shareholder oppression.[171]

### *2. The Supreme Court Opinion*

In *Ritchie v. Rupe*,[172] the Texas Supreme Court completely rejected the shareholder oppression doctrine as it had been developed in the Texas appellate courts. The Court first turned to the receivership statute as a source for the duties recognized by the shareholder oppression doctrine.[173] The court held that the "construction of former article 7.05, like any other statute, is a question of law for the courts."[174] "To determine the meaning of 'oppressive' in the receivership statute, our text-based approach to statutory construction requires us to study the language of the specific provision at issue, within the context of the statute as a whole, endeavoring to give effect to every word, clause, and sentence."[175] The Court focused particularly on the other statutory grounds for imposing a receiver, concluded that all involved a "serious threat to the well-being of the corporation," and held that "[w]e must construe

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165 *Ritchie*, 339 S.W.3d at 291.

166 *Id.* at 297.

167 TEX. BUS. ORGS. CODE ANN. § 11.404(a)(1)(C) (West 2012).

168 Petitioner's Brief on the Merits at 16, *Ritchie*, 443 S.W.3d 856 (No. 11-0447).

169 *Id.* at 15.

170 Respondent's Brief on the Merits at 17, *Ritchie*, 443 S.W.3d 856 (No. 11-0447) (quoting TEX. BUS. CORP. ACT arts. 7.05(A), 7.06(A) (West 2010)).

171 *Id* at 35.

172 443 S.W.3d at 866.

173 *Id.* at 863.

174 *Id.*

175 *Id.* at 867.

'illegal, oppressive, or fraudulent' . . . in a manner consistent with these types of situations."[176] The Court rejected the two definitions of oppressive that had been developed by the intermediate courts under the shareholder oppression doctrine and concluded:

> Considering all of the indicators of the Legislature's intent, we conclude that a corporation's directors or managers engage in 'oppressive' actions under former article 7.05 and section 11.404 when they abuse their authority over the corporation with the intent to harm the interests of one or more of the shareholders, in a manner that does not comport with the honest exercise of their business judgment, and by doing so create a serious risk of harm to the corporation.[177]

The basis of the court of appeal's holding of oppression, interference with the plaintiff's ability to sell her shares, "does not meet that standard."[178]

In the trial court, the plaintiffs had alleged additional oppressive conduct not relied on in the appellate opinion, but the Supreme Court held that remand was unnecessary because the plaintiff sought only a buy-out, and that remedy was not available under the receivership statute: "Former article 7.05 creates a single cause of action with a single remedy: an action for appointment of a rehabilitative receiver."[179] The Supreme Court rejected the argument that the provision in the receivership statute, requiring the court to find that all other remedies available at law or in equity are inadequate, implies the authority to order other appropriate equitable relief—"This provision is a restriction on the availability of receivership, not an expansion of the remedies that the statute authorizes."[180]

Next, the Court turned to the question of whether an independent cause of action should be recognized in the common law for shareholder oppression.[181] The Court held that such an inquiry requires "something akin to a cost-benefit analysis to assure that this expansion of liability is justified."[182] The factors include the foreseeability, likelihood, and magnitude of the risk of injury, the existence and adequacy of other protections against the risk, the magnitude of the burden of guarding against the injury and the consequences of placing that burden on the persons in question, and the consequences of imposing the new duty.[183] After a thorough discussion of the vulnerabilities of minority shareholder and the risks and harm caused by oppressive conduct, the Court concluded "that the foreseeability, likelihood, and magnitude of harm sustained by minority shareholders due to the abuse of power by those in control of a closely held corporation is significant, and Texas law should ensure that remedies exist to appropriately address such harm when the underlying actions are wrongful."[184] However, that conclusion "does not end our analysis" because "[w]e must next consider the adequacy of

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176 *Id.* at 868.
177 *Id.* at 871.
178 *Id.*
179 *Id.* at 872.
180 *Id.*
181 *Id.* at 877–78.
182 *Id.* at 878 (citing Roberts v. Williamson, 111 S.W.3d 113, 118 (Tex. 2003)).
183 *Id.*
184 *Id.* at 879.

remedies that already exist."[185]

The Court then analyzed the existing remedies in each of five areas where oppressive conduct is most frequently present: denial of access to information,[186] withholding of dividends,[187] termination of employment,[188] misappropriation of corporate funds and opportunities,[189] and manipulation of stock values.[190] As to denial of information, the Court noted that "[t]he Legislature has already dictated what rights of access a shareholder has to corporate books and records, and no party alleges that the Legislature's statutory scheme is inadequate to protect shareholders in closely held corporations from improper denial of access to corporate records."[191] As to termination of employment, "our commitment to the principles of at-will employment compels us to conclude that the opportunity to contract for any desired employment assurances is sufficient."[192] Misappropriation may be remedied through derivative claims based on "the duty of loyalty that officers and directors owe to the corporation specifically [that] prohibits them from misapplying corporate assets for their personal gain or wrongfully diverting corporate opportunities to themselves,"[193] which the Court reasoned might also be available to remedy withholding or refusing to declare dividends, termination of employment, and manipulation of corporate share values—"all relate to business decisions that fall under the authority of a corporation's offices and directors. As such, they are subject to an officer or director's fiduciary duties to the corporation."[194] Ultimately the Court concluded that "these legal duties are sufficient to protect the legitimate interests of a minority shareholder by protecting the well-being of the corporation."[195]

The Court also noted the potential negative consequences of recognizing a new common-law cause of action for shareholder oppression—that the undefined usage of the term "oppressive" falls far short of providing any clear standards[196] and that "[e]ven the most developed common-law standards for 'oppression'—the 'reasonable expectations' and 'fair dealing' tests—have been heavily criticized for their lack of clarity and predictability."[197]

The Court conceded:

> We recognize that our conclusion leaves a "gap" in the protection that the law affords to individual minority shareholders, and we acknowledge that we could fill the gap by imposing a common-law duty on directors in closely held corporations not to take

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185 *Id.*
186 *Id.* at 882.
187 *Id.*
188 *Id.* at 886.
189 *Id.* at 887.
190 *Id.*
191 *Id.* at 888.
192 *Id.* at 886.
193 *Id.* at 887.
194 *Id.* at 888.
195 *Id.* at 888–89.
196 *Id.* at 889.
197 *Id.* at 889–90.

> oppressive actions against an individual shareholder even if doing so is in the best interest of the corporation. To determine whether imposing such a duty is advisable, however, we must consider the public policies at play, the consequences of imposing the duty, the duty's social utility, and whether the duty would conflict with existing law or upset the Legislature's careful balancing of competing interests in governing business relationships.[198]

The Court reasoned, "[t]here must be well-considered, even compelling grounds for changing the law so significantly. . . . We find no such necessity here, and therefore decline to recognize a common-law cause of action for 'shareholder oppression.'"[199]

Finally, the Court noted that the plaintiff had also obtained jury findings of breach of fiduciary duties based on an informal fiduciary duty arising from the familial relationship among the parties and remanded the case for a determination of whether the plaintiff was entitled to a buy-out or other remedy based on that finding.[200] On remand, the Dallas Court of Appeals held that there was legally insufficient evidence to support fiduciary duties based on a relationship of trust and confidence among the parties and reversed the trial court's judgment and rendered judgment that Rupe take nothing.[201]

### C. Implications of *Ritchie*: Defining the "Gap"

The Texas Supreme Court "recognize[d] that our conclusion leaves a 'gap' in the protection that the law affords to individual minority shareholders."[202] What is that gap, and how will courts address it going forward?

#### *1. The need for a duty to individual shareholders*

To the extent that the matter was unclear prior to the *Ritchie* opinion,[203] the Texas Supreme Court made it abundantly clear that officers and directors of a corporation, are not in a legal relationship with the individual shareholders and owe their duties only to the corporate entity, not directly to the shareholders; [204] and, by necessary implication, the majority shareholders (who dictate the actions of the directors and officers) also owe no duties to the other shareholders.[205] What is left completely unexplained is whether the individual

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198 *Id.* at 889.

199 *Id.* at 891.

200 *Id.* at 892.

201 Ritchie v. Rupe, No. 05-08-00615-CV, 2016 WL 145581, at *1 (Tex. App.—Dallas Jan. 12, 2016, pet. filed) (mem. op.).

202 *Ritchie*, 443 S.W.3d at 889.

203 *Compare* Hoggett v. Brown, 971 S.W.2d 472, 488 (Tex. App.—Houston [14th Dist.] 1997, pet. denied) ("A director's fiduciary duty runs only to the corporation, not to individual shareholders or even to a majority of the shareholders. Similarly, a co-shareholder in a closely-held corporation does not as a matter of law owe a fiduciary duty to his co-shareholder."), *with id.* at 488 n.13 ("However, in certain limited circumstances, a majority shareholder who dominates control over the business may owe such a duty to the minority shareholder.").

204 *Ritchie*, 443 S.W.3d at 889.

205 The general rule has always been that co-shareholders owe no duties to each other merely by virtue of owning shares in the same corporation. *See* Kaspar v. Thorne, 755 S.W.2d 151, 155 (Tex. App.—Dallas 1988, no

shareholders are owed any duties whatsoever by anyone. This unanswered question may or may not be a "gap" in the law, but it is certainly a glaring hole in the jurisprudential scheme described in the *Ritchie* opinion. Does it mean anything legally to be a shareholder, a part owner in a corporation? If so, what duties, if any, are owed to individual shareholders by virtue of the shareholder status, who owes those duties, and how are those duties enforced?

*Ritchie* holds that an "officer or director has no duty to conduct the corporation's business in a manner that suits an individual shareholder's interests when those interests are not aligned with the interests of the corporation and the corporation's shareholders collectively."[206] This concept, as originally developed by the Texas Supreme Court, concerned the fact that injury to the corporation "ordinarily" harms the shareholder only indirectly.

> Ordinarily, the cause of action for injury to the property of a corporation or the impairment or destruction of its business, is vested in the corporation, as distinguished from its stockholders, even though it may result indirectly in loss of earnings to the stockholders. Generally, the individual stockholders have no separate and independent right of action for injuries suffered by the corporation which merely result in the depreciation of the value of their stock. This rule is based on the principle that where such an injury occurs each shareholder suffers relatively in proportion to the number of shares he owns, and each will be made whole if the corporation obtains restitution or compensation from the wrongdoer.[207]

There are strong policy reasons to make the corporation the only party that can seek redress for harm done to it, which only incidentally affects shareholders.[208] However, "a stockholder may sue for violation of his own individual rights regardless of whether the corporation also has a cause of action."[209] A shareholder may sue for breach of a contract involving and even benefitting the corporation if the shareholder is himself a party but not for a breach of contract to which the corporation alone is a party.[210] A shareholder may sue for corporate mismanagement if the "manager's misconduct violates some duty owed the stockholder independently."[211] "Rather, it is the nature of the wrong, whether directed against

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writ).

206 *Ritchie*, 443 S.W.3d at 889.

207 Massachusetts v. Davis, 168 S.W.2d 216, 221 (Tex. 1942).

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> This rule is based on the principle that where such an injury occurs each shareholder suffers relatively in proportion to the number of shares he owns, and each will be made whole if the corporation obtains restitution or compensation from the wrongdoer. Such action must be brought by the corporation, not alone to avoid a multiplicity of suits by the various stockholders and to bar a subsequent suit by the corporation, but in order that the damages so recovered may be available for the payment of the corporation's creditors, and for proportional distribution to the stockholders as dividends, or for such other purposes as the directors may lawfully determine.

*Id.*

209 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).

210 *Id.* at 918–19.

211 *Id.* at 919.

the corporation only or against the stockholder personally, which determines who may sue."[212] To recover individually, "a stockholder must prove a personal cause of action and personal injury."[213]

In a shareholder oppression scenario, the misconduct is specifically directed at the minority, with the primary injury being suffered by the minority, and only incidentally by the corporation, if at all. Assume that a majority shareholder wants to eliminate or marginalize the minority shareholder. If the corporation's profits were being distributed among the shareholders by means of wages, the majority shareholder uses his control over the board of directors to terminate the minority shareholder's employment; to ensure no dividends are declared; to cut off all information and participation in corporate affairs; and, typically, to raise the majority shareholder's compensation. Clearly, the intent and effect is to harm the minority shareholder—to eliminate the value of the shares to the minority shareholder. Has the corporation been harmed as well? Maybe. Maybe not. If the majority shareholder is an effective employee and manager, the corporation's business may not suffer. If the increase in the majority shareholder's compensation is equal to or less than what had been paid to the minority shareholder, then the corporation is in the same or perhaps slightly better shape economically. The value of the stock of the corporation as a whole, as opposed to that of the minority shareholder, is unaffected. The majority shareholder might even be able to argue with a straight face that the minority shareholder was troublesome, distracting, and not very talented, so that things will run much more smoothly and efficiently without the minority's meddling in corporate affairs. If the majority shareholder is correct, the corporation really is better off.

In a typical shareholder oppression case, the question is not whether the minority shareholder has suffered "personal injury"; the question is whether the minority shareholder has a "personal cause of action."[214] The *Ritchie* Court refused to "impos[e] a common-law duty on directors in closely held corporations not to take oppressive actions against an individual shareholder even if doing so is in the best interest of the corporation."[215] However, in an actual case of shareholder oppression, the best interests of the corporation are completely beside the point. Those interests neither motivate the oppressor, nor are they necessarily implicated one way or the other by the oppression. The Supreme Court did not adopt a rule that the best interests of the corporation trumps the best interests of the individual shareholder when the two are in conflict. Rather, the Supreme Court held that the majority shareholder in his control over the corporation has "no duty" to the minority shareholder, and thus eliminated the possibility of any personal cause of action, "even if [the oppressive conduct is] motivated by malice toward the stockholder individually."[216] The Supreme Court leaves "the legitimate interests of a minority shareholder" to be safeguarded only "by protecting the well-being of the corporation."[217] That protective scheme will often, perhaps usually, prove illusory.

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212 *Id.* at 918.

213 Wingate v. Hajdik, 795 S.W.2d 717, 719 (Tex. 1990).

214 *See id.* at 719.

215 Ritchie v. Rupe, 339 S.W.3d 275, 289 (Tex. App.—Dallas 2011), *rev'd*, 443 S.W.3d 856, 889 (Tex. 2014).

216 *Schoellkopf*, 739 S.W.2d at 919.

217 *Ritchie*, 443 S.W.3d at 888.

### *2. The need for an individual remedy*

Returning to the basic concept of shareholder oppression: "Oppressive" conduct is specifically targeted at an individual shareholder or group of shareholders. The purpose of that conduct is to diminish the value of the minority's share ownership—or rather to misappropriate the value of that ownership for the majority's benefit. If a majority owner is successful in actually eliminating the minority shareholder by either denying that he is an owner at all or inducing him to sell for a fraction of the value of his shares, the beneficiary of this wrongful conduct is the majority owner whose ownership in the enterprise necessarily increases as a result. In neither case is the corporation as a whole necessarily harmed or benefitted. The Supreme Court conceded that such unjust enrichment to the majority resulting from the majority's use of its power over corporation may be significantly harmful to the minority shareholder and that "Texas law should ensure that remedies exist to appropriately address such harm when the underlying actions are wrongful."[218] Yet the Supreme Court provides a legal scheme in which the minority shareholder's only remedy is an indirect one,[219] depending on the wrongful conduct directed at the minority shareholder also coincidentally harming the corporation. That seems an exceptionally odd result and one that is not consistent with longstanding Texas jurisprudence, which has always held that "[t]here are certain rights, powers, and privileges that accrue to a stockholder in a corporation."[220]

If the officers and directors or the controlling shareholders owe no duties to the minority shareholder, then nothing that the director or controlling shareholder does with the intent to harm the minority shareholder can possibly be actionable. If the oppressive scheme involves some incidental theft from the corporation, then the corporation may recover damages (directly or through a derivative action), and the minority shareholder gets his proportional share. But the malicious intent toward the minority shareholder, the fixed purpose of depriving him of his ownership interest, and the likelihood that those efforts will continue are legally irrelevant to the corporation's claim for damages. The minority shareholder would not have standing to request any relief to protect himself. Presumably, the trial court would not have jurisdiction to award such relief in favor of a non-party. The key fact on which the judgment was affirmed in *Davis v. Sheerin*, the conspiracy to deprive the minority shareholder of his ownership,[221] was not found in that case to have caused any actual harm.[222] It is difficult to imagine a claim that the corporation could bring that would address such conduct or any relief that could be granted

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[218] *Id.* at 879.

[219] It should be noted, however, that in certain situations, a shareholder may request the court to treat the derivative claim as a direct claim brought by the shareholder for the shareholder's own benefit. Then damages are paid directly to the shareholder and the shareholder may be awarded attorney's fees. TEX. BUS. ORGS. CODE. ANN. § 21.563 (West 2007).

[220] Turner v. Cattleman's Trust Co., 215 S.W. 831, 833 (Tex. 1919).

[221] Davis v. Sheerin, 754 S.W.2d 375, 382 (Tex. App.—Houston [1st Dist.] 1988, writ denied) ("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, we find that conspiring to deprive one of his ownership of stock in a corporation, especially when the corporate records clearly indicate such ownership, is more oppressive than either of those techniques.").

[222] *Id.* at 381 ("Appellants argue that the jury's finding of conspiracy was rendered immaterial by its finding that the conspiracy was not the proximate cause of any damages. . . . We overrule this argument. The court's judgment did not award damages based on a conspiracy cause of action. Instead, the court considered the various acts found by the jury and made a determination that such acts constituted oppressive conduct.").

to the corporation that would make the minority shareholder whole. In *Davis*, the court of appeals specifically held that injunctions and damages that might be granted for the breach of fiduciary duties to the corporation were inadequate to remedy the harm caused to the minority shareholder by the oppression.[223]

If the directors and controlling shareholders owe no duties to the minority, what about the corporation? Does the shareholder's stock certificate and status as an owner grant him any protection from corporate acts taken to harm his interests? Logic would seem to dictate that each shareholder must be in some sort of a legal relationship with the corporation, in which he has invested his capital and of which he holds an ownership interests. Does the corporation owe any legal duties to its individual owners? The answer must be "yes"—otherwise there would be no difference between being an owner and not being an owner. Clearly, there are certain statutory obligations that a corporation must observe toward its shareholders;[224] however, those statutory duties are largely a codification of common law duties already recognized by courts as arising from the legal relationship between the corporation and its shareholders.[225] While Texas law has long been clear that the remedy for wrongful conduct in the management or control of a corporation belongs to the corporation and may not be asserted directly by the shareholders,[226] Texas law has always been equally clear that there are exceptions in which the rights and remedies belong to the shareholders individually—"where the wrongdoer violates a duty arising from contract or otherwise, and owing directly" to the stockholder.[227]

### *3. Inadequacy of Piecemeal Approach*

Under the legal scheme described in the *Ritchie* opinion, a minority shareholder faced with a coordinated and intentional course of conduct, taken with the specific purpose of depriving him of the value of his share ownership and appropriating that value to the majority

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[223] *Id.* at 383 ("In this case, the award of damages and certain injunctions might be sufficient to remedy the willful breaches of fiduciary duty found by the jury, i.e., informal dividends to appellants by making contributions to the profit sharing plan and waste of corporate funds for legal fees. However, based on appellants' conduct denying appellee any interest or voice in the corporation, we find that these remedies are inadequate to protect appellee's interest and his rights in the corporation.").

[224] *See*, *e.g.*, BUS. ORGS. § 21.173 (corporation required to keep specific information regarding shares issued); *id* § 21.219 (corporation must provide annual financial statements to shareholders upon request); *id.* § 21.221 (corporation liable to shareholder who suffers damages because of the failure to properly provide notice of shareholders' meeting); *id.* § 21.354 (maintain and make available list of voting shareholders); *id.* § 21.455 (shareholders must approve sale of all or substantially all of corporation's assets); *id.* § 21.460 (shareholder has right of dissent and appraisal regarding certain fundamental business transactions).

[225] *See e.g.*, Sneed v. Webre, 465 S.W.3d 169, 179 (Tex. 2015) ("The Legislature's codification of shareholder derivative proceeding procedures . . . did not alter how the business judgment rule . . . applies to the merits of claims against a corporation's officers or directors for breach of corporate duties."); Hunter v. Fort Worth Capital Corp., 620 S.W.2d 547, 550 (Tex. 1981) ("Prior to the enactment of Article 7.12, Texas courts had long applied the trust fund theory to dissolved corporations, but only as embodied within the general framework of certain remedial statutes.").

[226] *See* Massachusetts v. Davis, 168 S.W.2d 216, 221 (Tex. 1942).

[227] *Id.* at 222 (emphasis added). The *Ritchie* opinion suggests that the "or otherwise" exception indicates instances of an informal fiduciary duty based on a relationship of trust and confidence. Ritchie v. Rupe, 443 S.W.3d 856, 888–89 n.58 (Tex. 2014). While that is certainly one example, no case has ever limited "or otherwise" to that one example.

shareholder, must break that pattern of oppressive conduct down into its component parts and pursue a remedy for each act in isolation. Not only is this approach cumbersome and inefficient, it ultimately denies the minority shareholder an adequate remedy. The ultimate purpose of the majority is to steal from the minority; however, that seemingly wrongful purpose is irrelevant to the analysis because the majority shareholder owes no duty to the minority shareholder as such. Furthermore, the business judgment rule ordinarily does not shield self-dealing from judicial scrutiny, but because the majority is stealing from the minority, rather than the corporation, the business judgment rule will continue to apply.[228]

Assume a squeeze out scenario: Two shareholders—one 49.9% and one 50.1%—organize a corporation, agreeing that whatever profits they are able to generate will be paid out as salary, which will be roughly equal. The two individuals have a falling out, and the majority shareholder decides to deprive the minority shareholder of all value so as to induce him either to sell or simply to disappear. Therefore, the majority shareholder takes action to exclude the minority from any voice or participation in management and to deny the minority any information about what is going on in the corporation. The majority shareholder terminates the minority shareholder's employment, or makes his life a "living hell" so as to force his resignation. Thereafter, the majority refuses to pay dividends and instead continues to pay out all profits in the form of salary—to himself.

Under the *Ritchie* scheme, the minority shareholder could force the majority to hold annual shareholder meetings by petitioning the district court every thirteen months for an order requiring such a meeting.[229] It does not appear that the minority would be able to recover his attorney's fees or expenses for such an effort, and the minority would be without any remedy for the majority's refusal to consider anything the minority shareholder had to say—no matter how malicious the majority's intent.

The minority could also make a written request for inspection of corporate records.[230] The majority could refuse and require a jury trial each time by merely asserting that the minority had an improper purpose.[231] Assuming the minority was successful, after several years of litigation, the minority would be permitted to inspect corporate records and would recover his attorney's fees. However, the statute does not provide for prospective relief, and the minority shareholder would be required to start the process all over again as the information he has acquired becomes dated and the majority continues to keep him in the dark.

Because the minority shareholder's only way to obtain his proportionate share of the profits generated has been through salary, he would want to bring a claim for the loss of employment. However, that claim would be futile because the minority shareholder is an at-will employee.[232] The Supreme Court suggested that there might be grounds for a derivative claim if the minority could prove that the decision to terminate his employment was not made

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[228] *See Sneed*, 465 S.W.3d at 173 ("The business judgment rule in Texas generally protects corporate officers and directors, who owe fiduciary duties *to the corporation*, from liability for acts that are within the honest exercise of their business judgment and discretion.") (emphasis added).

[229] BUS. ORGS. § 21.351.

[230] *Id.* § 21.218.

[231] Uvalde Rock Asphalt Co. v. Loughridge, 425 S.W.2d 818, 820 (Tex. 1968).

[232] *Ritchie*, 443 S.W.3d at 885 ("Texas is steadfastly an at-will employment state.").

solely for the benefit of the corporation;[233] however, the decision to terminate would most certainly be protected by the business judgment rule—if the majority could articulate a business reason for the termination, the court would not be permitted to interfere.

Alternatively, the minority shareholder might seek to force the payment of dividends. However, generally speaking, a shareholder has no specific right to dividends,[234] and the decision to pay dividends is almost completely protected by the business judgment rule.[235] Furthermore, because the majority shareholder is paying out all profits in the form of salary, there is no surplus from which dividends may be paid.[236]

If the minority cannot compel payment of his proportional share of the profits by means of damages for wrongful termination or compelling payment of dividends, he may bring a derivative suit for the majority's excessive compensation. Unfortunately, a claim for excessive compensation is extremely difficult to prove. Compensation decisions are inherently subjective. Courts are extremely deferential to compensation decisions.[237] The factors include: (1) the employee's qualifications; (2) the nature, extent and scope of the employee's work; (3) the size and complexities of the business; (4) a comparison of salaries paid with gross income and net income; (5) the prevailing general economic conditions; (6) comparison of salaries with distributions to stockholders; (7) the prevailing rates of compensation for comparable positions in comparable concerns; (8) the salary policy of the corporation as to all employees; and (9) in the case of small corporations with a limited number of officers, the amount of compensation paid to a particular employee in previous years.[238] The issue that will be presented to the jury is whether the majority shareholder is paying himself more than the market rate for other presidents of successful companies. As a practical matter, most defendants are able to justify almost any salary based on a comparison to the market because of the wide range of executive salaries, and the majority shareholder will justifiably be able to argue that, since the minority shareholder doesn't work here anymore, the majority shareholder is doing more work, and the salary reflects the results he is achieving for the corporation. If the minority shareholder is successful, then he will be entitled to his 49.9% of the amount of excessive compensation in damages—which will almost certainly be less than he would have been paid but for the oppression.[239] Furthermore, the damages award will not be prospective.

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[233] *Id.* at 886 ("There may be situations in which, despite the absence of an employment agreement, termination of a key employee is improper, for no legitimate business purpose, intended to benefit the directors or individual shareholders at the expense of the minority shareholder, and harmful to the corporation. Though the ultimate determination will depend on the facts of a given case, such a decision could violate the directors' fiduciary duties to exercise their 'uncorrupted business judgment for the sole benefit of the corporation' and to refrain from 'usurp[ing] corporate opportunities for personal gain.'").

[234] ARGO Data Res. Corp. v. Shagrithaya, 380 S.W.3d 249, 273 (Tex. App.—Dallas 2012, pet. denied) ("A shareholder has no right to dividends.").

[235] *Ritchie*, 443 S.W.3d at 883; *ARGO*, 380 S.W.3d at 270; *Bryan v. Sturgis Nat'l Bank*, 90 S.W. 704, 705 (Tex. Civ. App. 1905, writ ref'd). *See* BUS ORGS. § 21.302.

[236] BUS. ORGS. § 21.303.

[237] Gibney v. Culver, No. 13-06-112-CV, 2008 WL 1822767, at *14 (Tex. App.—Corpus Christi Apr. 24, 2008, pet. denied) (mem. op.) (citing Mayson Mfg. Co. v. Comm'r, 178 F.2d 115, 119 (6th Cir. 1949) ("[T]he action of the Board of Directors of a corporation in voting salaries for any given period is entitled to the presumption that such salaries are reasonable and proper.").

[238] *Id.* at *13–14 (citing Rutter v. Comm'r, 853 F.2d 1267, 1271 (5th Cir. 1988)).

[239] Take an easy example: Say the majority is paid $50,100 annually and the minority is paid $49,900. The

Although the minority shareholder would be compensated for his attorneys' fees, he will be faced with going through the same process all over again if the unrepentant majority shareholder continues the same practice.

One other significant question is raised by the Supreme Court's recent decision in *Sneed v. Webre*.[240] The *Ritchie* scheme "to protect the legitimate interests of a minority shareholder by protecting the well-being of the corporation"[241] depends heavily on the Court's repeated assertion that a shareholder may bring a derivative action against the directors for violating the "duty to act solely for the benefit of the corporation."[242] Decisions that violate that duty, even if malicious and oppressive, do not necessarily involve self-dealing and dishonesty toward the corporation. The *Ritchie* opinion strongly indicates that any use of control over the corporation for reasons other than furthering the bests interests of the corporation would be actionable, but *Ritchie* does not explain whether the business judgment rule would preclude judicial scrutiny of such decisions. The *Sneed* decision reiterates that duty,[243] but expressly does not decide "which duties are subject to the business judgment rule."[244] It does make clear, however, that "the business judgment rule applies as a defense to the merits of a shareholder's derivative lawsuit that asserts claims against the corporation's officers or directors for breach of duties that result in injury to the corporation."[245] Thus, even under the legal protections articulated by the *Ritchie* opinion, oppressive conduct that violates the duty to act solely for the benefit of the corporation may still escape judicial scrutiny.

### *4. Need for the Buy-Out Remedy*

The holding in *Ritchie* seems to have eliminated the buy-out remedy for oppressed minority shareholders. The Court held that the legislative intent of Section 11.404 of the Business Organizations Code and its predecessors did not provide for such a legal protection.[246] The Court held that "'"[o]ur task is to effectuate the Legislature's expressed intent'; it is not to impose our personal policy choices or 'to second-guess the policy choices that inform our statutes or to weigh the effectiveness of their results.'"[247] However, the Court neglected a cardinal rule of statutory interpretation. The Business Organizations Code adopts the rules of code construction in Chapter 311 of the Government Code,[248] which presumes of

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majority fires the minority and immediately increases his own compensation to $100,000. The jury finds that the $49,900 increase is excessive compensation in breach of fiduciary duties to the corporation. What has the minority shareholder lost? $49,900 annually. What does the minority recover in the derivative action? $24,900, or 49.9% of the excessive compensation. The majority keeps the rest and continues to be unjustly enriched.

240 465 S.W.3d 169 (Tex. 2015).

241 Ritchie v. Rupe, 443 S.W.3d 856, 888 (Tex. 2014).

242 *E.g.*, *id.* at 884; Sutton v. Reagan & Gee, 405 S.W.2d 828, 834 (Tex. Civ. App.—San Antonio 1966, writ ref'd n.r.e.) ("All courts seem to agree that a director owes a duty to the corporation to exercise due care in the management of the corporation's affairs.").

243 *Sneed*, 465 S.W.3d at 178.

244 *Id.* at 178 n.7.

245 *Id.* at 178–79.

246 *Ritchie*, 443 S.W.3d at 872 ("Former article 7.05 creates a single cause of action with a single remedy: an action for appointment of a rehabilitative receiver.").

247 *Id*. at 866 (Tex. 2014) (quoting *In re* Allen*,* 366 S.W.3d 696, 703 (Tex.2012); and Iliff v. Iliff*,* 339 S.W.3d 74, 79 (Tex.2011)).

248 TEX. BUS. ORGS. CODE ANN. § 1.051 (West 2015).

every statute that "(1) compliance with the constitutions of this state and the United States is intended; (2) the entire statute is intended to be effective; (3) a just and reasonable result is intended."[249] The constitutional mandate of all corporate statutes in Texas is that "General laws . . . providing for the creation of private corporations . . . shall therein provide fully for the adequate protection of the public and of the individual stockholders."[250] In interpreting the statute so as to effectively eliminate legal protection from oppressive conduct, the Court hardly upheld the constitutional mandate to "provide fully for the adequate protection . . . of the individual stockholders" or for a "just and reasonable result." The dissent justifiably criticized the Court for "ignoring the plain language of the statute and the great weight of authority" and holding "that an oppression statute abolishes the remedies it expressly prefers."[251]

None of the remedies discussed by the Supreme Court address an intentional and continuing pattern of misconduct. None provide a way out of an oppressive situation for which the Supreme Court admits that the law should provide a remedy. What made the shareholder oppression doctrine work as an effective means of dealing with oppressive conduct was not the protection of "reasonable expectations" or the requirement of "fair dealing," both of which may very well be protected by other causes of action, but was the compulsory buy-out remedy, which provided a way to end a pattern of oppressive conduct and to restore completely to the oppressed minority shareholder what had been wrongfully taken. The buy-out remedy allowed the minority shareholder to escape an oppressive situation. The remedy was entirely fair, as the *Davis v. Sheerin* court noted, because it ultimately gave the majority shareholder exactly what he wanted but just required payment of fair compensation.[252] As the dissent in *Ritchie* argued, "No other existing remedy the Court discusses adequately protects minority shareholders from such oppression."[253]

Derivative actions against individual components of a pattern of oppression do not consider the overall harm of the scheme as a whole. The plaintiff's termination of employment might be seen by the court as unfortunate and unfair, but the employment at will doctrine gives majority in control of the corporation the absolute right to do so. The refusal to declare dividends might harm the minority shareholder but can be justified as the business judgment of the majority with which courts will not interfere. The overly generous salary that the majority shareholder pays himself can probably be justified as not above the wide range of salaries paid to executives in private corporations. Any damages awarded on the basis of such claims would not include damages anticipated to occur in the future based on conduct that has not yet happened. The shareholder oppression doctrine allowed the court to look at the entire pattern of the defendant's behavior and conclude that the termination, refusal to pay dividends, and compensation decisions were all made with the purpose and effect of denying the minority any benefits from stock ownership. The shareholder oppression doctrine allowed the court to take into consideration more intangible factors, such as bad faith denial of share ownership, denial of any voice in corporate affairs, and disrespect of someone who is supposed to be an owner in

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249 TEX. GOV'T CODE ANN. § 311.021 (West 2015).

250 TEX. CONST. art. XII, § 2.

251 *Ritchie*, 443 S.W.3d at 900 (Guzman, J., dissenting).

252 Davis v. Sheerin, 754 S.W.2d 375, 383 (Tex. App.—Houston [1st Dist.] 1988, writ denied) ("Appellants' oppressive conduct, along with their attempts to purchase appellee's stock, are indications of their desire to gain total control of the corporation. That is exactly what a 'buy-out' will achieve.").

253 *Ritchie*, 443 S.W.3d at 905 (Guzman, J., dissenting).

the business, which are all but impossible to compensate.[254] The shareholder oppression doctrine allowed the court to consider whether the defendant's actions were likely to continue in the future. In many cases, the only practical way to protect the minority shareholder is to allow the minority shareholder to transfer back to the corporation or to the majority the stock that the oppressive conduct has rendered valueless and to require the majority to pay a fair price for what he has taken. As one court has stated: "From the controlling shareholders' point of view, the buy-out may be more costly, but such a remedy provides an effective means of fairly compensating the aggrieved shareholder here. The buy-out remedy fits the situation . . . ."[255]

Derivative suits may award damages for past wrongs and injunctive relief to curb some misconduct, but it is difficult to imagine a court ordering a buy-out of an individual shareholder in a derivative action brought for the benefit of the corporation.[256]

### *5. Future development*

The Supreme Court stated that numerous statutory and contractual protections and other common-law remedies currently exist to protect against oppressive conduct.[257] The Court specifically stated that "we do not foreclose the possibility that a proper case might justify our recognition of a new common-law cause of action to address a 'gap' in protection for minority shareholders."[258] The Court also noted that numerous traditional common-law causes of action already exist that may address oppressive conduct. "Relying on the same actions that support their oppression claims, Texas minority shareholders have also asserted causes of action for: (1) an accounting, (2) breach of fiduciary duty, (3) breach of contract, (4) fraud and constructive fraud, (5) conversion, (6) fraudulent transfer, (7) conspiracy, (8) unjust

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[254] *Davis*, 754 S.W.2d at 383 ("In this case, the award of damages and certain injunctions might be sufficient to remedy the willful breaches of fiduciary duty found by the jury, i.e., informal dividends to appellants by making contributions to the profit sharing plan and waste of corporate funds for legal fees. However, based on appellants' conduct denying appellee any interest or voice in the corporation, we find that these remedies are inadequate to protect appellee's interest and his rights in the corporation.").

[255] Stefano v. Coppock, 705 P.2d 443, 446 (Alaska 1985).

[256] A court may have the equitable power to fashion a buy-out remedy, but there is no logical connection between any claim brought for the benefit of the corporation and a remedy that causes the corporation to buy out a single shareholder. Nevertheless, such a result might not be impossible. One authority noted: "Several older cases suggest that a forced buyout of a plaintiff may be utilized in derivative proceedings as an alternative to other remedies, such as setting aside a transaction." 13 FLETCHER CYC. CORP. § 6038.10 (2015) (citing Am. Seating Co. v. Bullard, 290 F. 896, 900 (6th Cir. 1923)). *See also* Demarest v. Winchester Repeating Arms Co., 257 F. 162, 175 (D. Conn. 1919); Jones v. Missouri-Edison Elec. Co., 233 F. 49, 52 (8th Cir. 1916); Jones v. Missouri-Edison Elec. Co., 203 F. 945, 949 (8th Cir. 1913); Backus v. Brooks, 195 F. 452, 454–55 (2d Cir. 1912); Binney v. Cumberland Ely Copper Co., 183 F. 650, 653 (D. Me. 1910); In *Duncan v. Lichtenberger*, the court crafted an equitable remedy of rescission and restitution, returning to the minority shareholders their investment in the corporation, as a remedy for conduct that was clearly a breach of fiduciary duties to the corporation. 671 S.W.2d 948 (Tex. App.—Fort Worth 1984, writ ref'd n.r.e.). The Business Organizations Code provides that a derivative action in a closely-held corporation "may be treated by a court as a direct action brought by the shareholder for the shareholder's own benefit." TEX. BUS. ORGS. CODE ANN. § 21.563 (West 2007). Therefore, the possibility of a buy-out order in a proper case cannot be ruled out completely, however unlikely that result seems to be.

[257] *Ritchie*, 443 S.W.3d at 879–80.

[258] *Id.* at 890.

enrichment, and (9) quantum meruit."[259] The majority opinion repeatedly cites classic shareholder oppression doctrine cases with approval regarding claims asserted other than oppression.[260]

The Court made clear that "we have not abolished or even limited the remedies available under the common law or other statutes for the kinds of conduct that give rise to rehabilitative receivership actions, whether under the oppressive-actions prong or other prongs. . . . [T]he actions that give rise to oppressive-action receivership claims typically also give rise to common-law claims as well, opening the door to a wide array of legal and equitable remedies not available under the receivership statute alone. Those remedies, whether lesser or greater, are not displaced by the rehabilitative receivership statute, which merely adds another potential remedy available in extraordinary circumstances when lesser remedies are inadequate."[261] Therefore, in light of the *Ritchie* decision, there is a new urgency in re-examining what legal rights and remedies "already exist"[262] to protect individual minority shareholders against oppressive conduct.

## IV. REDISCOVERING INDIVIDUAL COMMON-LAW SHAREHOLDER CLAIMS

> A corporate stockholder may, however, have an action for personal damages for wrongs done to him as an individual stockholder 'where the wrongdoer violates a duty arising from contract or otherwise, and owing directly by him to the stockholder.' This principle, often mischaracterized an exception to the general rule that stockholders may not sue for personal injury resulting from a violation of the corporation's rights, simply recognizes that a stockholder may sue for violation of his own individual rights regardless of whether the corporation also has a cause of action. It is not personal injury which gives rise to a personal cause of action by the stockholder, for an injurious wrong to the corporation perforce injures its stockholders. Rather, it is the nature of the wrong, whether directed against the corporation only or against the stockholder personally, which determines who may sue.[263]

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[259] *Id.* at 882 (citing Boehringer v. Konkel, 404 S.W.3d 18, 24 (Tex. App.—Houston [1st Dist.] 2013, no pet.)); ARGO Data Res. Corp. v. Shagrithaya, 380 S.W.3d 249, 262 (Tex. App.—Dallas 2012, pet. denied); Allen v. Devon Energy Holdings, L.L.C., 367 S.W.3d 355, 365 (Tex. App.—Houston [1st Dist.] 2012, pet. granted, judgm't vacated w.r.m.); Strebel v. Wimberly, 371 S.W.3d 267, 274 (Tex. App.—Houston [1st Dist.] 2012, pet. denied); Adams v. StaxxRing, Inc., 344 S.W.3d 641, 643 (Tex. App.—Dallas 2011, pet. denied); Redmon v. Griffith, 202 S.W.3d 225, 231 (Tex. App.—Tyler 2006, pet. denied); DeWoody v. Rippley, 951 S.W.2d 935, 944 (Tex. App.—Fort Worth 1997, no writ); *Davis*, 754 S.W.2d at 377).

[260] *Id.* at 882, 885.

[261] *Id*. at 875 n.28.

[262] *Id.* at 879.

[263] Schoellkopf v. Pledger, 739 S.W.2d 914, 918 (Tex. App.—Dallas 1987), *rev'd*, 762 S.W.2d 145 (Tex. 1988).

### A. Re-examining *Stinnett v. Paramount-Famous Lasky Corp. of N.Y.*

*Stinnett v. Paramount-Famous Lasky Corp. of New York*,[264] involved a claim by shareholders of a corporation, not against the controlling shareholders or management, but against third parties arising from harm to the corporation. In 1923, the two plaintiffs, who held the lease to a movie theater in Dallas, Texas, formed a corporation for the purpose of engaging in the Class A theater business.[265] The corporation secured a contract with the defendants for the distribution of films to show in the theater, but the plaintiffs were frustrated with their inability to obtain quality films, resulting ultimately in an altercation with one of the defendants, who threatened physical violence, declared that he would not renew the contract, and swore that he would see to it that the plaintiffs "did not get a decent picture to operate [the] theater."[266] As a result, in late 1925, the plaintiffs quit the theater business and sold the lease and the corporation. The plaintiffs sued the defendants for the destruction of their business on breach of contract and antitrust theories and received a favorable jury verdict and a judgment in the amount of $318,770.[267] The defendants appealed, and the Waco Court of Appeals reversed the case on based solely on the fact that the harm was to the corporation and not to the plaintiffs individually:

> The cause of action for injury to or destruction of the property of a corporation or the impairment or destruction of its business is nevertheless vested in the corporation, as distinguished from its stockholders. In such cases the injury to the corporation is direct and the injury to the holders of its stock remote. A recovery by the corporation inures to their benefit in proportion to their respective holdings and affords them compensation for the indirect or consequential loss sustained by them.[268]

The court of appeals remanded the case for new trial.[269] The Texas Commission of Appeals affirmed the reversal and remand based on defective jury questions and evidentiary errors.[270] However, the Court reject the defendants' argument that "the undisputed evidence as a matter of law show that the sole cause of action against defendants belongs to the Capitol Amusement Company, a corporation, and that plaintiffs have no cause of action either in their individual capacities or as stockholders of the Capitol Amusement Company," which had been the basis of the court of appeals' decision.[271]

The Court acknowledged the "general rule [that] an action to redress or prevent injuries to the corporation cannot be maintained by a stockholder or the body of stockholders in their own names . . .[], but the action must be brought by, and in the name of, the corporation itself. This

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[264] 37 S.W.2d 145 (Tex. Comm'n App. 1931, holding approved, judgm't affirmed).

[265] *Id.* at 146.

[266] *Id.* at 147.

[267] *Id.* at 147–48.

[268] Paramount Famous Lasky Corp. v. Stinnett, 17 S.W.2d 125, 127–28 (Tex. Civ. App.—Waco 1929), *aff'd*, 37 S.W.2d 145.

[269] *Id.* at 128. The opinion does not explain the reason for the remand. The grounds for the reversal would seem to call of judgment to be rendered in favor of the defendants.

[270] 37 S.W.2d 145.

[271] *Id.* at 149.

is true, although the injury to the corporation may incidentally result in the destruction or depreciation of the value of the stock. . . .[] The stockholders cannot as individuals recover on a cause of action vested in the corporation, although all unite in the action."[272] However, the Court also stated the exception to the general rule, that individual stockholder may maintain a direct action in their individual capacity for "wrongful acts which are not only wrongs against the corporation but also violations of duties arising from contracts or otherwise and owing directly to the injured stockholders."[273] This is the first case in Texas to state this often-repeated exception to the general rule.[274] The plaintiffs argued that they had been injured individually by:

> the ruthless and illegal acts of defendants that drove them out of the moving picture business, and that, by reason of such acts on the part of defendants, plaintiffs were not permitted to continue, either through a corporation or individually, in the moving picture business in which they had been successfully engaged for many years,[275]

and, particularly because they held the lease to the theater building individually, the plaintiffs contended, "that they were injured in a way that the corporation, which owned no physical assets and had no interest in the lease, could not have suffered injury."[276]

The first opinion to state the exception that shareholder may sue individually for harm to the corporation when the wrongdoing also violates "a duty arising from contract, or otherwise, and owing directly by him to the stockholders" was the Sixth Circuit case of *Ritchie v. McMullen*,[277] authored by Judge William Howard Taft,[278] which was discussed at length in the

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[272] *Id.*

[273] *Id.*

[274] *E.g.*, Sneed v. Webre, 465 S.W.3d 169, 188 (Tex. 2015); Murphy v. Campbell, 964 S.W.2d 265, 268 (Tex. 1997); Wingate v. Hajdik, 795 S.W.2d 717, 719 (Tex. 1990); Massachusetts v. Davis, 168 S.W.2d 216, 222 (Tex. 1942); BDO USA, L.L.P. v. Litex Indus., Ltd., No. 05-15-00358-CV, 2016 WL 3198503, at *8 (Tex. App.—Dallas May 26, 2016, no. pet. h.) (mem. op.); Aloysius v. Kislingbury, No. 01-13-00147-CV, 2014 WL 4088145, at *3 (Tex. App.—Houston [1st Dist.] Aug. 19, 2014, no pet.) (mem. op.) (not designated for publication); Murphy v. Am. Rice, Inc., No. 01-03-01357-CV, 2007 WL 766016, at *12 n.36 (Tex. App.—Houston [1st Dist.] Mar. 9, 2007, no pet.) (mem. op.); Goeth v. Craig, Terrill & Hale, L.L.P., No. 03-03-00125-CV, 2005 WL 850349, at *6 (Tex. App.—Austin Apr. 14, 2005, no pet.) (mem. op.); Villasana v. Patout, Cannon & Co., No. 01-98-00109-CV, 1999 WL 1018160, at *2 (Tex. App.—Houston [1st Dist.] Nov. 10, 1999, no pet.) (mem. op.) (not designated for publication) ("A corporate stockholder cannot personally recover damages for a wrong done solely to the corporation, even though she may be injured by that wrong."); Gannon v. Baker, 807 S.W.2d 793, 798 (Tex. App.—Houston [1st Dist.]), *rev'd in part*, 818 S.W.2d 754 (Tex. 1991); Faour v. Faour, 789 S.W.2d 620, 622 (Tex. App.—Texarkana 1990, writ denied); Bush v. Brunswick Corp., 783 S.W.2d 724, 727 (Tex. App.—Fort Worth 1989, writ denied); Horton v. Robinson, 776 S.W.2d 260, 263 (Tex. App.—El Paso 1989, no writ); MBank Abilene, N.A. v. LeMaire, No. C14-86-00834-CV, 1989 WL 30995, at *14 (Tex. App.—Houston [14th Dist.] Apr. 6, 1989, no writ); Schoellkopf v. Pledger, 739 S.W.2d 914, 918 (Tex. App.—Dallas 1987), *rev'd*, 762 S.W.2d 145 (Tex. 1988); Cullum v. Gen. Motors Acceptance Corp., 115 S.W.2d 1196, 1201 (Tex. Civ. App.—Amarillo 1938, no writ); Gaubert v. United States, 885 F.2d 1284, 1291 (5th Cir. 1989), *rev'd*, 499 U.S. 315 (1991); Seibu Corp. v. KPMG L.L.P., No. 3-00-CV-1639-X, 2001 WL 1167317, at *6 (N.D. Tex. Oct. 2, 2001).

[275] 37 S.W.2d at 149.

[276] *Id.* at 150.

[277] 79 F. 522, 533 (6th Cir. 1897).

[278] Later President of the United States and 10th Chief Justice of the United States Supreme Court.

*Stinnett* opinion.[279] *Ritchie v. McMullen* involved a shareholder who had borrowed large sums of money and pledged his stock in several corporations as collateral—corporations over which his creditors had control. The shareholder appealed the refusal by the trial court to permit the amendment of his answer to add counterclaims against the creditors for damage to the value of his pledged shares resulting from alleged intentional mismanagement of the corporations.[280] The trial court had held that the amendment was improper because "that the wrongs committed were injuries to the corporations only, and that Ritchie, as a stockholder, could have no redress directly against the wrongdoers, and must find a remedy, if at all, in the enhancement in value to his stock caused by a recovery of damages by the corporations."[281] Judge Taft pointed out the paradox of the general rule: "As the very object of the conspiracy and wrongs done was to cause Ritchie to cease to be a stockholder, it might be difficult to point out how such an indirect remedy could benefit him after the wrong had been completed and he had parted with his ownership of the stock."[282] The court noted that generally shareholders have no claim for harm to the corporation that results in the depreciation of the value of their shares, but held: "But we are of opinion that this principle has no application where the wrongful acts are not only wrongs against the corporation, but are also violations by the wrongdoer of a duty arising from contract, or otherwise, and owing directly by him to the stockholders."[283] The court reasoned that the basis of the general rule was the absence of privity between individual shareholders and the officers and directors of the corporation, who owe their duties to the corporation, but here the shareholder was in privity with the officers and directors because of the pledge of stock, which carried with it a duty on the pledgee of reasonable care as to the value of the pledge: "A fortiori it is the bailor's duty not to do any act with the intention of depreciating the value of the pledge. Hence, if Payne, Burke, and Cornell combined together, and wrongfully reduced the value of the stocks pledged, with the intention of buying them in at less than their value, they have done Ritchie an injury, for which he is entitled to compensation."[284] The court held that the directors would not be liable for negligent or ill-advised decisions that incidentally damaged the value of the pledged shares, "[b]ut, if such pledgee use his position as director and his vote as stockholder intentionally to depreciate the stock of his pledgor held in pledge with the dishonest purpose of acquiring ownership of the stock at forced sale, this is a direct injury done by him to his pledgor, and he cannot avoid direct liability to his pledgor for it, by pleading that the means by which he accomplished this wrong, and violated his duty as pledgee, involved an injury to the corporation, for which it may also recover damages."[285] Nor would the creditors be liable for voting their own shares in a manner that resulted in damage to the pledged shares, "unless the vote is shown to be malicious; i.e. with intent to injure the person complaining. But it is well settled that, 'if any number of persons combine with intent to injure and defraud another, they cannot defend themselves against an action by showing that they did the act in the character of corporators under any charter whatever.[']"[286]

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279 *See* 37 S.W.2d at 150.

280 *See* 79 F. at 529.

281 *Id.* at 533.

282 *Id.*

283 *Id.*

284 *Id.*

285 *Id.* at 534.

286 *Id.*

The *Stinnett* Court accepted the Sixth Circuit's reasoning and held: "In applying these principles, we think it equally well settled that, if it appears from the pleadings and the proof that the wrongful acts are not only wrongs committed against the corporation, but also violations of duties arising from contracts or otherwise and owing directly to the injured stockholders, the stockholder should be permitted to file and maintain a suit for injuries sustained as a stockholder and as an individual."[287] Therefore, because the plaintiffs had alleged violation of the antitrust laws that arguably established a legal duty to themselves, they would be permitted to pursue an individual claim that involved actions that harmed the company. "We are in entire accord with the proposition that the well-recognized rules of law and equity should not be so strictly construed as to produce an irremediable situation or a total failure of justice, but, under proper pleadings and proof, those rules should, if necessary, be relaxed to promote the ends of justice and to furnish the litigant a forum in which to redress his alleged wrongs."[288] The Court did express skepticism as to whether the plaintiffs had actually established antitrust violations as to themselves, but because the case was to be remanded for new trial in any event, the Court merely noted the suggestion that, "in our opinion, plaintiffs have not, in the development of this phase of the case, sufficiently complied with the exceptions to the general rule herein stated."[289]

### B. Re-examining *Cates v. Sparkman*

In the landmark case of *Cates v. Sparkman*,[290] the Texas Supreme Court upheld the dismissal of a minority shareholder's lawsuit against the corporation and its directors and other shareholders for damages caused to the shareholder resulting from the decision to cease business operations and liquidate the corporation. The plaintiff filed suit claiming that the corporation and the other defendants breached duties owed to him as a shareholder. The defendants answered by general demurrer and special exceptions, and the trial court dismissed the lawsuit. The plaintiff appealed, and the Supreme Court affirmed the dismissal.

In the opinion, the Court wrote the classic statement of the business judgment rule in Texas:

> It may be safely said that courts of equity have not, as a general rule, been disposed to exercise their jurisdiction through suits like the present to control or interfere in the management of the corporate or internal affairs of an incorporated company. The company's business is left to the direction of the officers or managing board which, by the law creating it, may be clothed with the power and discretion to conduct its affairs in the manner which, in their judgment, is best calculated to promote its interests.[291]
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> . . . .

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[287] 37 S.W.2d at 150–51.

[288] *Id.* at 150.

[289] *Id.* at 151.

[290] 11 S.W. 846 (Tex. 1889).

[291] *Id.* at 848.

> [I]f the acts or things [challenged by the plaintiff shareholder] are or may be that which the majority of the company have a right to do, or if they have been done irregularly, negligently, or imprudently, or are within the exercise of their discretion and judgment in the development or prosecution of the enterprise in which their interests are involved, these would not constitute such breach of duty, however unwise or inexpedient such acts might be, as would authorize the interference by the courts at the suit of a stockholder.[292]

The *Cates* opinion is significant in three respects: First, it is the "seminal"[293] case in Texas describing the business judgment rule, has been cited consistently as authority for that legal doctrine for more than 125 years,[294] and has recently been reaffirmed by the Texas Supreme Court as the leading Texas authority in that regard.[295] Second, it describes the procedural elements necessary to bring a common-law shareholder's derivative claim, which requirements have now been codified and superseded by statute.[296] Third, it describes the kinds of claims that a shareholder may bring individually against the corporation for corporate actions that damage him personally as a shareholder. This last aspect of the opinion has been largely overlooked by Texas courts, but is of renewed importance in determining whether existing common law fills the gaps created when *Ritchie* eliminated shareholder oppression as an individual cause of action for damage done personally to minority shareholders.

### *1. Facts*

Distinguishing the holding in *Cates v. Sparkman* regarding individual claims from the holding regarding derivative claims requires careful scrutiny of the procedural posture of the case, the Court's reasoning, and the precise wording of the holding. The plaintiff in *Cates* was a shareholder in Wise County Coal Company and brought suit in his individual capacity against that corporation, together with its officers, directors, and the remaining shareholders. The plaintiff claimed to have been the owner of certain tracts of land and the lessee of others that contained valuable coal deposits. He and the other individual defendants entered into an agreement to form a corporation for the purpose of developing the deposits. The plaintiff conveyed the land and leasehold interests to the corporation in exchange for stock. The defendants were unsuccessful in raising sufficient capital, and "after the defendants had expended about $15,000 in money, employed hands, purchased machinery, and placed the plaintiff in charge of the mines, as superintendent, to develop the same, the work under the directors continued for about two months, when, against his prote[s]t, some of the hands were discharged; []. . .the work was then continued for four months; and, at the expiration of that time, the development of the mines was arrested, and the machinery sold to one [shareholder]

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292 *Id.* at 849.

293 Sneed v. Webre, 465 S.W.3d 169, 182 (Tex. 2015).

294 *See* Gearhart Indus., Inc. v. Smith Int'l, Inc., 741 F.2d 707, 721 (5th Cir. 1984); TTT Hope, Inc. v. Hill, No. H-07-3373, 2008 WL 4155465 (S.D. Tex. Sept. 2, 2008); F.D.I.C. v. Benson, 867 F. Supp. 512, 515 n.2 (S.D. Tex. 1994); Pace v. Jordan, 999 S.W.2d 615, 623 (Tex. App.—Houston [1st Dist.] 1999, pet. denied); Langston v. Eagle Publ'g Co., 719 S.W.2d 612, 617 (Tex. App.—Waco 1986, writ ref'd n.r.e.).

295 *Sneed*, 465 S.W.3d at 173, 178–88.

296 *Id.* at 186.

of the company."[297] The plaintiff, having given up his valuable minerals interests holdings, was left only with worthless stock.

The plaintiff's suit was based on two legal theories: the defendants' "fraudulent acts" to devalue his stock and obtain his coal mining assets, and "their failure to comply with their contract" under which he originally invested his assets into the corporation.[298] On the fraud claim, plaintiff's petition alleged that the conduct of the directors "from the beginning were done for the purpose, and with the intent, to defraud plaintiff out of his property," that the decision to cease operations was "for the purpose of financially ruining plaintiff, and defrauding him out of his property," and that the "object of said defendants was to depreciate said stock and acquire the whole of said property for a nominal consideration."[299] On the contract claim, the plaintiff's petition alleged that "plaintiff has complied with his part of the agreement" and that "defendants had refused to comply with their part of said agreement; that, by such failure and refusal, they have damaged plaintiff."[300] The plaintiff requested the relief of canceling his shares and an award of damages.[301]

### *2. Holdings*

*Cates v. Sparkman* was not a derivative suit. It was a direct claim by a shareholder in his individual capacity asserting the violation of legal duties owed directly to himself—fraud and breach of contract. In rejecting those claims, the Texas Supreme Court also explicitly recognized the existence and validity of such an individual claim and such duties, in "a proper case."[302] In order to understand the reasoning of the Court in the *Cates* opinion, it is necessary to look at *Evans v. Brandon*,[303] a similar case decided by the Texas Supreme Court just eight years prior to *Cates v. Sparkman*.

In *Evans*, the plaintiff was a shareholder in Texas Banking and Insurance Company and brought suit against the members of the board of directors of that corporation, claiming that "in the conduct of the company's business the defendants were so careless, negligent, reckless, and imprudent in making loans and discounts, permitting the same to be made by the subordinate officers of the bank, as to impair the capital of the company to the amount of $170,000, and cause a depreciation of more than $50 per share in the market value of the stock, including the shares held and owned by plaintiff."[304] The plaintiff sought damages in the sum of $3,760 for the depreciation in the value of his stock.[305] The Supreme Court made short work of the plaintiff's suit, holding: "On principle and authority, it is clear that the liability of directors for a breach of duty that injures the corporate property as a whole, is primarily to the corporation whose agents they are."[306] The Court held that the plaintiff could not assert these claims in his

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297 *Cates*, 11 S.W. at 849.
298 *Id.* at 847.
299 *Id.*
300 *Id.*
301 *Id.*
302 *Id.* at 849.
303 Evans v. Brandon, 53 Tex. 56 (1880).
304 *Id.* at 57.
305 *Id.* at 58.
306 *Id.* at 60.

individual capacity:

> A recovery by the corporation for such an injury would inure to the benefit of its stockholders, and in that way, they would be compensated for the indirect injury received. If the corporation refuses to sue, or is still under the control of the directors sought to be held responsible, a stockholder may maintain an equitable proceeding 'to protect the interest of the corporation as the trustee for all its stockholders and creditors.'
>
> A fatal defect in the plaintiff's petition, both original and amended, is, that it seeks no recovery in behalf of the corporation, but seeks a direct recovery of damages for the plaintiff individually, the case stated not entitling him to such a recovery.[307]

It would seem that the plaintiff's claim in the *Cates* case suffered the same "fatal defect." The first of eleven special exceptions filed by the defendants was that "an action of this kind cannot be maintained against the directors for damages to corporate property or stock, except in the name of the company."[308] The *Cates* Court was clearly aware of the *Evans* decision, citing it twice.[309] Had the Supreme Court in *Cates* believed that there were no legal duties owed to individual shareholders, and that shareholders could not bring suit in their individual capacities for damage to the value of their shares, the Court would simply have upheld the dismissal on the basis of the defendants' first special exception and written a very short opinion, as it had done in *Evans*. It did not do so.

The *Cates* Court stated, "Applying to the petition the most liberal and reasonable construction of which its language is susceptible, there are but two aspects in which the case made by it can be properly considered."[310] The case was either a claim by an individual shareholder against the corporation seeking damages for loss of the value of his shares caused by the misconduct of the officers,[311] or it was a claim by an individual shareholder against the corporation seeking cancellation of his shares and damages (i.e., rescission of the subscription agreement and restitution of the consideration) based on breach of the contract by which the plaintiff acquired his shares.[312] Neither of these alternatives describes a derivative claim asserted on behalf of the corporation. In both instances, the Court recognizes that there are situations in which a plaintiff would be able to assert a direct claim on his own behalf for damage done to himself as a shareholder under either a claim for breach of legal duties owed by the corporation to the shareholder or for breach of a contract to which the shareholder is a party.

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307 *Id.* at 60–61 (citations omitted).

308 Cates v. Sparkman, 11 S.W. 846, 847 (Tex. 1889).

309 *Id.* at 849–50.

310 *Id.* at 848.

311 *Id.*

312 *Id.* at 850. This notion that individual duties arise either from contract or other tort duty is repeated in subsequent cases acknowledging that there are exceptions to the rule that shareholders may only sue derivatively for wrongful conduct that results in damage to the value of their shares. *See, e.g.*, Massachusetts v. Davis, 168 S.W.2d 216, 222 (Tex. 1942) (noting the "exception to the above rule, where the wrongdoer violates a duty arising from *contract or otherwise*, and owing directly by him to the stockholder.") (emphasis added).

The Court first analyzed the validity of the plaintiff's "fraud" claim—"[t]reating it first as a suit in equity by an individual stockholder of shares in an incorporated company, against the latter [that is, against the company], to recover damages for the depreciation in the value of his stock and the corporate property, occasioned by the fraudulent practices and conduct of the officers and directors."[313] The plaintiff's argument was that "such a suit may be brought when said officers have fraudulently conspired together to take advantage of plaintiff, or where they have fraudulently misapplied corporate property or funds, and the stockholder has suffered loss by depreciation in the value of his stock, or special damage, when the corporation refuses to sue, or the allegations are such as show a virtual refusal by the company to sue,"[314] which is plainly wrong because these elements describe a derivative suit—an "equitable proceeding to protect the interest of the corporation as the trustee for all its stockholders and creditors," as the Supreme Court had described in *Evans*.[315]

The Court's analysis following this statement is somewhat confusing because the Court accepts without examination the plaintiff's position that the individual claim for fraud against the company required satisfying the three elements necessary for a derivative claim. "The concurrence of three things is regarded as indispensable as the basis for such a suit: The company must refuse to sue; there must be a breach of duty; there must be injury to the stockholder."[316] However, the Court does this with the proviso that is determining whether the plaintiff's petition satisfies its own theory because the authorities cited were not "altogether reconcilable."[317] The Court's application of the rule is telling. The first element, demand futility, was "comparatively free from difficulty" as the plaintiff is claiming that the entire board was guilty of wrong-doing.[318] The "more serious question arises" as to whether the plaintiff has adequately pleaded breach of duty and harm.[319] In analyzing whether or not a breach of duty has been alleged, the Court clearly articulates the business judgment rule that actions that are "done irregularly, negligently, or imprudently, or are within the exercise of their discretion and judgment in the development or prosecution of the enterprise" are not a breach of duty "however unwise or inexpedient such acts might be,"[320] and that shareholders may not bring a lawsuit just because they "might be dissatisfied with the progress of the work or enterprise in which the company was engaged, or the manner in which it might be conducted by the directors or board authorized to conduct it . . . upon the ground that the enterprise or work of the company was not being carried on, or was being delayed or arrested in a manner not, in his judgment, conducive to the interests of stockholders."[321] But, nowhere does the Court inquire as to whether the board members were disloyal to the corporation or "fraudulently misappropriate[d] the corporate property in any manner, or obtain[ed] any undue advantage, benefit, or property for themselves by contract, purchase, sale, or other dealings under cover of their official functions, or in any manner commit[ted] a breach of their

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313 *Cates*, 11 S.W. at 848 (emphasis added).

314 *Id.*

315 *Evans*, 53 Tex. at 60.

316 *Cates*, 11 S.W. at 849.

317 *Id.* at 848 ("[Q]uestion then is, are the allegations sufficient to maintain this character of suit, when tested by the rules condensed from a comparison of the authorities not altogether reconcilable in this class of cases.").

318 *Id.* at 849.

319 *Id.*

320 *Id.*

321 *Id.*

obligations" to the corporation,[322] which omission is surprising given that the petition specifically alleged that the "object of said defendants" was to "acquire the whole of said property for a nominal consideration" and that the defendants had "sold all tools and machinery to defendant Carpenter for less than their value."[323] However, the plaintiff did not sue for that alleged misappropriation of corporate property; he sued only for his own individual loss. The Court rejected the plaintiff's petition as not stating a breach of duties based on the fact that the conduct about which he complained constituted nothing more than actions that "the majority of the company have a right to do,"[324] not because the plaintiff had failed to allege a breach of duty to the corporation, but because the plaintiff had failed to allege any "illegal exercise of discretion subversive of the plaintiff's rights."[325] Likewise, on the third element of harm, the Court concludes, not that the petition had failed to allege harm to the corporation, but that the petition had not adequately alleged individual harm to the plaintiff: "The value of the plaintiff's stock is at no time clearly stated, nor what its value would have been if the undertaking had been successful."[326]

It is important to keep in mind throughout the discussion that the case was not brought as a derivative action; it was brought individually by the plaintiff for damages suffered by him personally as a result of the loss of the mining assets he invested. The plaintiff asserted no claim for harm to the company, only for harm to the plaintiff. The plaintiff pleaded no cause of action on behalf of the company; rather, the company was a defendant from which the plaintiff was seeking damages. The Court makes clear in the second sentence of the opinion that it is analyzing the claim as "a suit in equity by an individual stockholder of shares in an incorporated company, against the latter [against the company], to recover damages for the depreciation in the value of his stock and the corporate property, occasioned by the fraudulent practices and conduct of the officers and directors"[327]—a claim by a shareholder against the corporation for damage done to the shareholder, not a claim by a shareholder on behalf of the corporation for damage done to the corporation. And, most importantly, the holding of the Court was not that the claim should have been brought derivatively, as had been the holding in *Evans*, but that the "the petition does not allege such facts as would authorize the suit by plaintiff, as an individual stockholder, against the company for damages in the depreciation of the value of his stock."[328]

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[322] *Id.* at 848.

[323] *Id.* at 849.

[324] *Id.*

[325] *Id.* This aspect of the opinion bears careful scrutiny. The holding is not that the business judgment rule shields fraudulent conduct by the directors against a shareholder. The plaintiff's theory was that the directors' management of the entire business was done for the purpose of fraudulently inducing the plaintiff to trade his property for stock and then using their control over the corporation to render the stock worthless, shut down the corporation, and obtain its assets. *Id.* Interestingly, the opinion does not describe what happened to the minerals interests after the corporation shut down, although indicate that one of the defendant shareholders acquired the machinery. Nevertheless, the *Cates* opinion should not be read to state that the business judgment rule would be a defense to such a theory of liability. On the contrary, the Court clearly states that courts do not defer to corporate management on claims of fraud. *See id.* Rather, the holding should be understood to be that the facts pleaded in the plaintiff's petition did not state a claim for fraud against the shareholder, but at best described a claim of negligent breach of the duty of care that directors owe to the corporation, and that the business judgment rule would bar such a claim for negligence.

[326] *Id.* at 849–50.

[327] *Id.* at 848.

[328] *Id.* at 850. A claim "by plaintiff, as an individual stockholder, against the company for damages in the

In defining such individual claims, the Court states that the general policy not to interfere with the authority of the management of a corporation to conduct business[329] is subject to certain exceptions.[330] Two categories of such claims "justify the interposition of the courts."[331] First, there are derivative claims, which the Court defines as claims against officers and directors for harm to the corporation caused by "negligence or culpable lack of prudence, or a failure to exercise their functions, or fraudulently misappropriate[ing] the corporate property in any manner, or obtaining] any undue advantage, benefit, or property for themselves . . . or in any manner commit[ing] a breach of their obligations,"[332] which claims must be brought by the corporation, no matter what the indirect loss may be suffered by the shareholder, or by a shareholder "suing representatively for all others similarly situated," if, and only if, the corporation refuses to bring the suit.[333] Second, in certain limited circumstances, an individual shareholder *may* bring a direct claim for "damage in the depreciation of his stock":

> 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.[334]

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depreciation of the value of his stock" is not a quaint nineteenth-century way of saying "derivative suit." An earlier passage in the opinion that unambiguously refers to a derivative suit characterizes such an action as an "equitable suit against the wrong-doing directors or officers for relief [that] can be maintained by an individual shareholder suing representatively for all others similarly situated." *Id.* at 849. Other opinions by the same court written at about the same time refer to derivative actions as an "equitable proceeding [brought by a shareholder] 'to protect the interest of the corporation as the trustee for all its stockholders and creditors.'" *Evans*, 53 Tex. at 60–61 (seeking "recovery in behalf of the corporation [and not] a direct recovery of damages for the plaintiff individually"); Becker v. Dirs. of Gulf City State Ry. & Real Estate Co., 15 S.W. 1094, 1097 (Tex. 1891) (suit seeking a recovery "for the use and benefit of the company"). The statement that the lawsuit in *Cates* was by "an individual stockholder against the company for damages" means exactly what it says.

329 *Cates*, 11 S.W. at 848.

330 *Id.* ("To justify the interposition of the courts there must exist, as a foundation for such suit, some action—a threatened action of such board or officers which is beyond the power conferred by its charter—or such fraudulent transaction completed, contemplated among themselves, or with others, as will result in serious injury to the stockholders suing.").

331 *Id.*

332 *Id.* at 848.

333 *Id.* at 848–49 ("Where the directors or officers, or some of them, cause a loss of corporate property by negligence or culpable lack of prudence, or a failure to exercise their functions, or fraudulently misappropriate the corporate property in any manner, or obtain any undue advantage, benefit, or property for themselves by contract, purchase, sale, or other dealings under cover of their official functions, or in any manner commit a breach of their obligations, then the corporation is the party to bring the suit in equity; and whatever be the nature of the wrong in cases of this character, whether intentional or fraudulent, or resulting from carelessness, negligence, or imprudence, and whatever may be the indirect loss occasioned to individual stockholders, no equitable suit against the wrong-doing directors or officers for relief can be maintained by an individual shareholder suing representatively for all others similarly situated, unless the corporation, either actually or virtually, refuses to prosecute.").

334 *Id.* at 849.

This often-quoted[335] (or misquoted) sentence does not describe the limits of the business judgment rule applicable in derivative suits, nor does it describe the threshold requirements for a shareholder to bring a derivative action, and grammatically could not be so interpreted. The sentence describes those kinds of misconduct that would permit suit by a plaintiff, "as an individual stockholder, against the company for damages in the depreciation of the value of his stock."[336]

The Court describes three kinds of situations in which an individual shareholder may assert such an individual claim. First, shareholders may sue directly for misconduct "characterized by ultra vires."[337] Second, shareholders may sue directly for "fraudulent" misconduct.[338] Third, shareholders may sue directly for "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." This third category cannot mean anything other than a direct action by the shareholder for breach of duties owed to the shareholder. These claims are based on misconduct on the part of "the company or its controlling agency" that are "clearly subversive of the rights of the minority, or of a shareholder"—not for harm to the company or violation of duties to the company but impairment of the "rights of the minority" or even of a single shareholder—and only in situations where, if the individual shareholder could not sue directly, he would be left "remediless."

The Court reviews of the allegations in the plaintiff's petition to determine whether the type of misconduct alleged states a "breach of duty authorizing a suit by an individual stockholder for damage in the depreciation of his stock."[339] The lawsuit was based on decisions by the directors in running the business, "[b]ut it is not alleged that this was done in any manner other than that which the directors may have had a right to do, or ought to have done,"[340] and there was no allegation consistent with "fraud, oppression, or abuse of power."[341] The Court concludes that the "character of fraudulent practices, oppressive conduct, abuse of power, and an illegal exercise of discretion subversive of the plaintiff's rights are not shown on the part of the officers and directors of the company which are held to be necessary to maintain a suit of this kind"[342]—again, "this kind" of suit, the Court states repeatedly, is an individual claim by a shareholder against the company. The Court holds: "As the case is presented, we are of the opinion that the petition does not allege such facts as would authorize the suit by plaintiff, as an individual stockholder, against the company for damages in the

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335 Tow v. Bulmahn, No. 15-3141, 2016 WL 1722246, at *11 (E.D. La. Apr. 29, 2016); Resol. Trust Corp. v. Norris, 830 F. Supp. 351, 356 (S.D. Tex. 1993); Villasana v. Patout, Cannon & Co., No. 01-98-00109-CV, 1999 WL 1018160, at *7 (Tex. App.—Houston [1st Dist.] 1999, no pet.); Langston v. Eagle Publ'g Co. 719 S.W.2d 612, 617 (Tex. App.—Waco 1986, writ ref'd n.r.e.).

336 *Cates*, 11 S.W. at 850 (emphasis added).

337 That was the law then and now. TEX. BUS. ORGS. CODE ANN. § 20.002(c)(1) (West 2006).

338 Fraud on a shareholder is always a direct action. *In re* Seven Seas Petroleum, Inc., 522 F.3d 575, 586 (5th Cir. 2008).

339 *Cates*, 11 S.W. at 849.

340 *Id.*

341 *Id.*

342 *Id.*

depreciation of the value of his stock, and injury to the corporate property."[343]

Finally, the Court turns to the plaintiff's other individual claim, breach of contract: "Treating the case as one for damages for the breach of a contract by the defendants, and for the recovery of prospective profits which might have been realized if the contract to develop the mines and construct the railroad had been carried out . . . ."[344] The problem with this claim is not want of a duty, but proof of damages. "[I]t is only necessary to say that what his stock would have been worth, and the probable enhanced value of the corporate property if the enterprise embarked in had been successful, are elements of damage too remote to form the basis for a recovery, even if they had been alleged with sufficient certainty."[345]

### *3. Subsequent Treatment*

The language used by the *Cates* court to describe the few types of situations in which a shareholder has an individual cause of action against the company has been grossly misconstrued in some subsequent cases. In *Langston v. Eagle Publishing Co.*,[346] the court indicated that a shareholder had standing to bring a derivative action only in the extremely narrow instances where *Cates* had ruled the shareholder had an individual claim:

> Before a shareholder can bring a derivative suit in the right of a corporation, . . . the shareholder must plead and prove that the board of directors' refusal to [pursue the claim] was '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.'[347]

On its face, the statement could not possibly mean that. A derivative suit is brought by the shareholder on behalf of the corporation against officers and directors who have violated duties to the corporation that resulted in harm to the corporation. Requiring the shareholder to plead and prove that "the company or its controlling agency [had] clearly subvert[ed] of the rights of the minority, or of a shareholder" would be wholly immaterial to the corporation's cause of

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[343] *Id.* at 850. The Texas Supreme Court in *Ritchie* characterized the holding in *Cates* as "affirming dismissal of shareholder's claim against company's controller for devaluation of shares brought by shareholder individually because right of action belonged to corporation." Ritchie v. Rupe, 443 S.W.3d 856, 876 n.31 (Tex. 2014). This shocking misstatement of the case presumably reflects nothing more than a failure to read it. The one thing that the *Cates* opinion did *not* do was dismiss the claim because the claim belonged to the corporation. One might argue that *Cates* was a derivative claim that the Court dismissed as a result of applying the business judgment rule, as other cases have construed the opinion, *see infra* note 355, but as has been argued here, that construction of the opinion ignores the Court's own statement of the facts and issues in the case and the wording of the Court's holding.

[344] *Cates*, 11 S.W. at 850.

[345] *Id.*

[346] 719 S.W.2d 612 (Tex. App.—Waco 1986, writ ref'd n.r.e.).

[347] *Id.* at 616–17. *Accord* Pace v. Jordan, 999 S.W.2d 615, 623 (Tex. App.—Houston [1st Dist.] 1999, pet. denied) ("To show that the decision was governed by something other than sound business judgment, appellants had to prove 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 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.").

action. Construing the limited instances in which a shareholder has an individual claim as being the only instances in which a shareholder can bring a derivative action cannot be reconciled with *Cates* description of a shareholder derivative action just a few pages before in which the Court described a broad range of situations in which "corporation is the party to bring the suit in equity" against officers and directors who "cause a loss of corporate property by negligence or culpable lack of prudence," fail to exercise their functions, misappropriate the corporate property "in any manner," obtain "any undue advantage, benefit, or property for themselves," or "in any manner commit a breach of their obligations."[348] In all of these situations, the corporation may sue the officers and directors, but a "shareholder suing representatively for all others similarly situated," may not "unless the corporation, either actually or virtually, refuses to prosecute."[349] If a shareholder could bring a derivative suit only after pleading and proving "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," then a shareholder could not possibly "sue representatively," when the corporation refuses to do so, in all the situations mentioned in the *Cates* opinion. This specious construction was recently argued to and rejected by the Texas Supreme Court in *Sneed v. Weber*.[350] Without stating whether or not it had ever been the law that derivative claims were so limited, the Court held that the common-law standing requirements for derivative claims have now been superseded by statute.[351]

In another regard, the Court's discussion of *Cates* in *Sneed v. Weber* is raises serious questions. The Supreme Court in *Sneed* made clear that, although the language in *Cates* had no application as to derivative standing, it may have application in the determination of the merits.

> [T]he business judgment rule traditionally is implicated twice within the life cycle of a shareholder derivative proceeding brought on behalf of a corporation. First, the business judgment rule applies to the board of directors' decision whether to pursue the corporation's cause of action. Second, the business judgment rule applies as a defense to the merits of a shareholder's derivative lawsuit that asserts claims against the corporation's officers or directors for breach of duties that result in injury to the corporation.[352]

The *Sneed* opinion states the principle in *Cates* that

> an officer or director's breach of duty that would authorize court interference 'is that which is characterized by ultra vires, fraudulent, and injurious practices, abuse of

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348 *Cates*, 11 S.W. at 848–49.

349 *Id.*

350 Sneed v. Webre, 465 S.W.3d 169, 180 (Tex. 2015) ("To obtain standing under the defendants' theory, Webre would have to plead and prove that the board of directors' failure to pursue the corporate cause of action was '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.'").

351 *Id.* at 186.

352 *Id.* at 178–79.

> 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'

is still the law.[353] "Accordingly, the pronouncement of the business judgment rule in *Cates*, with respect to breaches of duty, goes 'in reality to the right of the plaintiff to relief rather than to the jurisdiction of the court to afford it.'"[354] Therefore, the question remains as to whether the statement "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" defines the very limited circumstances in which a shareholder may have a direct claim against the corporation or describes the application of the business judgment rule in a derivative claim brought for the benefit of the corporation. Several cases have incorrectly seized on this language as a description of the business judgment rule applied in a derivative action: "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."[355]

> In Texas, the business judgment rule protects corporate officers and directors from being held liable to the corporation for alleged breach of duties based on actions that are negligent, unwise, inexpedient, or imprudent if the actions were 'within the exercise of their discretion and judgment in the development or prosecution of the enterprise in which their interests are involved.'[356]

The business judgment rule may be interposed as a defense in a suit instituted by the corporation as well as a derivative suit brought on behalf of a corporation.[357] There is a huge gulf between not imposing liability on officers and directors when they are merely "negligent, unwise, inexpedient, or imprudent" and only imposing liability on officers and directors when their actions are "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

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353 *Id.* at 186 (quoting *Cates*, 11 S.W. at 849).

354 *Id.* at 187 (quoting Dubai Petroleum Co. v. Kazi, 12 S.W.3d 71, 76–77 (Tex. 2000)).

355 Gearhart Indus., Inc. v. Smith Int'l, Inc., 741 F.2d 707, 721 (5th Cir. 1984); Floyd v. Hefner, 556 F. Supp. 2d 617, 634 (S.D. Tex. 2008). *See also In re* Life Partners Holdings, Inc., No. DR-11-CV-43-AM, 2015 WL 8523103, at *7 (W.D. Tex. Nov. 9, 2015) ("In addition to being unbiased toward the other defendants, the Outside Directors can have no personal interest in seeing that the derivative claims are dismissed to avoid their own liability."); Resol. Trust Corp. v. Holmes, No. H-92-0753, 1992 WL 533256, at *6 (S.D. Tex. Aug. 7, 1992) ("[T]he 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 debtor."); Langston v. Eagle Publ'g Co., 719 S.W.2d 612, 616–17 (Tex. App.—Waco 1986, writ ref'd n.r.e.) (explaining that shareholder in derivative suit must do more than show board's actions were unwise); Zauber v. Murray Savings Ass'n, 591 S.W.2d 932, 936 (Tex. Civ. App.—Dallas 1979, writ ref'd) ("[I]f fraudulent, deceptive, or improper conduct underlies that action a court may declare it invalid.").

356 *Sneed*, 465 S.W.3d at 178 (quoting *Cates*, 11 S.W. at 849).

357 *E.g.*, Game Syss., Inc. v. Forbes Hutton Leasing, Inc., No. 02-09-00051-CV, 2011 WL 2119672, at *2 (Tex. App.—Fort Worth May 26, 2011, no pet.) (Corporation sued directors for breach of fiduciary duty, fraud, conversion; directors asserting business judgment rule as defense); Pace v. Jordan, 999 S.W.2d 615, 624 (Tex. App.—Houston [1st Dist.] 1999, pet. denied) (Shareholders brought derivative suit against directors for breach of fiduciary duty due to poor investment strategies; directors successfully invoked protection of business judgment rule).

of the rights of the minority, or of a shareholder." If *Cates* meant to limit officer and director liability to the corporation only to the latter, then the Court's other statement that the corporation had a claim against officers or directors who "cause a loss of corporate property by negligence or culpable lack of prudence," fail to exercise their functions, misappropriate the corporate property "in any manner," obtain "any undue advantage, benefit, or property for themselves," or "in any manner commit a breach of their obligations"[358] is nonsense. The Texas Supreme Court in *Ritchie* was at pains to emphasize that officers and directors "owe a fiduciary duty to the corporation in their directorial actions, and this duty 'includes the dedication of [their] uncorrupted business judgment for the sole benefit of the corporation.'"[359] The majority opinion repeats that standard of liability no less than five times.[360] The court states that "when a corporate director violates the duty to act solely for the benefit of the corporation . . . minority shareholders are entitled to relief, either directly to the corporation or through a derivative action."[361] The same standard is repeated in *Sneed*.[362] Again the notion that directors are liable directly to the corporation or through a derivative suit whenever they fail to "act solely for the benefit of the corporation" cannot be reconciled with the notion that they are only liable for acts "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." *Sneed* leaves the matter somewhat ambiguous.

### C. Re-examining *Patton v. Nicholas*

The courts of appeals' opinions that developed the shareholder oppression doctrine[363] relied heavily on the significant 1955 Texas Supreme Court opinion in *Patton v. Nicholas*.[364] The *Ritchie* Court held this reliance was misplaced.[365] Nevertheless, the *Ritchie* opinion made it abundantly clear that *Patton* is still good law.[366]

#### *1. Facts*

The *Patton* case involved a Dallas company called the Machinery Sales & Supply Company, which was initially a profitable sole proprietorship owned by the defendant in the case.[367] The two plaintiffs were "young salaried employees," who were each rewarded with a 10% interest in the profits of the company in 1940, which was increased to 20% each in

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358 *Cates,* 11 S.W. at 848–49.

359 Ritchie v. Rupe, 443 S.W.3d 856, 868 (Tex. 2014) (quoting Int'l Bankers Life Ins. Co. v. Holloway, 368 S.W.2d 567, 577 (Tex. 1963)).

360 *See id.* at 868, 883, 884, 886.

361 *Id.* at 884.

362 *Sneed*, 465 S.W.3d at 178 (quoting *Ritchie*, 443 S.W.3d at 868).

363 *See* Boehringer v. Konkel, 404 S.W.3d 18 (Tex. App.—Houston [1st Dist.] 2013, no pet.); ARGO Data Res. Corp. v. Shagrithaya, 380 S.W.3d 249 (Tex. App.—Dallas 2012, pet. denied); Ritchie v. Rupe, 339 S.W.3d 275 (Tex. App.—Dallas 2011), *rev'd,* 443 S.W.3d 856; Redmon v. Griffith, 202 S.W.3d 225, 234 (Tex. App.—Tyler 2006, pet. denied); Davis v. Sheerin, 754 S.W.2d 375 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

364 279 S.W.2d 848 (Tex. 1955).

365 *Ritchie*, 443 S.W.3d at 876.

366 *See id.* at 876, 883–84.

367 *Id.* at 849.

1943.[368] In 1944, the defendant's attempt to revoke the arrangement was met with the plaintiffs' insistence that they were partners. Ultimately, the parties entered into a written settlement agreement in August 1945, providing for the incorporation of the business, the issuance of the stock 60% to the defendant and 20% to each of the plaintiffs, and providing that all three would be directors and officers for the initial year and setting their salaries for that year.[369] All of this was put into place by October 1945, and within days, "hostilities were resumed."[370] The defendant berated the plaintiffs in front of subordinate employees and circulated reports criticizing the plaintiffs among the employees that the Supreme Court characterized as "not only quite inappropriate and offensive . . . but also a threat that their tenure of office and employment would probably be short."[371] Both plaintiffs resigned in December 1945 and started a competing business as the settlement agreement expressly permitted them to do.[372] No dividends were paid over the next six years; the defendant received a generous, but not excessive, salary, while the plaintiffs received nothing at all.[373] During this time, "the net worth of the corporation steadily increased, the surplus coming up from zero to about $130,000."[374] In January 1946, the defendant wrote to a third party that "he intended to use his power as majority stockholder arbitrarily to the prejudice of the respondents. The letter also referred to the respondents in defamatory terms such as 'crooked.'"[375] Employees testified at trial that the defendant had made statements to the effect that he would see to it that no dividends would be paid so long as the plaintiffs were stockholders, that he bore strong personal ill will toward the plaintiffs, and that "he would not buy the stock of respondents for even a small fraction of its value or sell his own at any price."[376] The plaintiffs were not re-elected as directors, and were replaced with individuals who were "plainly little more than nominees and representatives" of the defendant.[377]

The plaintiffs filed suit in 1951 and went to trial on the primary theory that

> they were [fraudulently] induced to effect a dissolution of their partnership and transfer money, property and assets of the partnership to the corporation and that the consideration for such had failed, and that the corporation was nothing more or less than a vehicle of fraud to effect and bring about malicious diversion, confiscation, etc., of [plaintiffs'] properties and assets, and that said corporation has been a continuing fraud, and that the corporate entity should be disregarded and set aside and an accounting of all properties, moneys and assets be immediately carried out through a receivership with power to liquidate and divide the business. . . .[378]

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368 *Id.*

369 *Id.* at 849–50.

370 *Id.* at 850.

371 *Id.*

372 *Id.* at 850–51.

373 *Id.* at 851.

374 *Id.*

375 *Id.*

376 *Id.* at 851–52.

377 *Id.* at 851.

378 Patton v. Nicholas, 269 S.W.2d 482, 483 (Tex. Civ. App.—El Paso 1954), *aff'd in part, rev'd in part*, 279 S.W.2d 848 (Tex. 1955). It is interesting to note that this was almost exactly the same theory of liability pleaded by the

The plaintiffs also made claims for damages caused to them by the defendant's mismanagement and refusal to pay dividends.

> The verdict included findings that the parties were partners just before the settlement was made; that [defendant] made the settlement 'with the intention of wrongfully excluding' the respondents 'from the management, control, operation, and sharing of profits in the business'; . . . that he 'wrongfully dominated and controlled the Board of Directors so as to prevent the declaration of dividends'; that he did this 'for the sole purpose of preventing [plaintiffs] from sharing in the profits to be derived from the operation of the corporation' as well as 'for the sole purpose of depreciating the value of the shares of the stock in said corporation, owned by [plaintiffs], to a lower value than such shares of stock would otherwise have'; that he was 'guilty of mismanagement of the corporation' (mismanagement being defined in the charge as 'bad, improper, or unskillful management, resulting in injury to the corporation'); . . . that [defendant] 'was acting with malice toward [plaintiffs] in the acts of mismanagement and domination of the Board of Directors; but that he did not cause himself to be paid an excessive salary in the years 1949 and 1950.[379]

Damages issues were submitted on "the depreciation in value, if any, of the [plaintiff's] stock" and "the loss of dividends, if any, that should have been paid during such period of time."[380] The jury awarded $110,610 in actual damages and $10,000 in exemplary damages.[381] The trial court rendered a judgment on the fraud claim and entered an order that the corporate entity should be disregarded and dissolved and a receiver appointed to liquidate and divide accordingly.[382] The trial court disregarded the damages award on the grounds that the plaintiffs were "forced into an election between standing on the agreement and asking for damages, or voiding the agreement and disregarding the corporate entity and asking a return of the property."[383] The court of appeals affirmed.[384]

### *2. Holdings*

Supreme Court rejected out of hand the "rescission for fraud" claim on which the trial court's judgment was based and affirmed by the court of appeals[385] in part because the plaintiffs "expressly disclaim seeking rescission of that agreement."[386] The Court held that the plaintiff's theory of the case did not state a fraud claim and that "their real complaint is less that the petitioner misrepresented his true state of mind, than that he later and wrongfully suppressed dividends or mismanaged the corporation or both."[387] Therefore, the Court recast

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plaintiff in *Cates v. Sparkman. See Cates*, 11 S.W. at 847.

379 *Patton*, 279 S.W.2d at 852.

380 *Id.*

381 *Id.* at 849.

382 *Patton*, 269 S.W.2d at 484.

383 *Id.* at 485.

384 *Id.* at 487.

385 *Patton*, 279 S.W.2d at 852.

386 *Id.* at 853.

387 *Id.*

the judgment as one for mismanagement and suppression of dividends and the order of a liquidating receiver as based on those claims. The Court held that the mismanagement claims were not supported by the evidence.[388] The Court held that the finding of general domination and control of the board of directors by the majority shareholder did not state a claim.[389]

"But the finding of his control of the board for the malicious purpose of, and with the actual result of, preventing dividends and otherwise lowering the value (if meaning current sale value in the market place) of the stock of the respondents, is something else."[390] The Court noted that the "evidence as to the wrongful state of mind" was "quite adequate" and that the connection between the malicious intent and the withholding of dividends was "enough."[391] The Court found the "statement of the petitioner about purchasing their stock could not unreasonably be interpreted as indicating a purpose to acquire it eventually for much less than its value."[392]

> We do believe that, coupling all the circumstances indicating the petitioner's intent to eliminate the respondents 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 must be sustained,
>
> along with the necessarily implied finding that, but for the "wrongful conduct of the [defendant] and the corporation under his dominance, dividends in some substantial amount would have been declared"—although there was no finding as to the amount.[393]

The Supreme Court stated that a "minority stock interest is far from 'change left on the counter'" and held that wrongful conduct against that minority interest through "the malicious suppression of dividends is a wrong akin to breach of trust, for which the courts will afford a remedy."[394] However, the "character of the remedy is another question."[395] The trial court had ordered a receiver to liquidate the corporation and distribute its assets on the ground that the incorporation had been fraudulent and could be disregarded, which the court of appeals held was within the trial court's power and authority to do.[396] Approaching the liquidation as an equitable remedy for malicious suppression of dividends, the issue was more complex. The defendant contended that liquidation of a solvent corporation was either "wholly beyond the power of courts" or at least "wholly improper in cases like the present one."[397] After a lengthy

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[388] *Id.*

[389] *Id.*

[390] *Id.*

[391] *Id.*

[392] *Id.*

[393] *Id.* at 854.

[394] *Id.*

[395] *Id.*

[396] Patton v. Nicholas, 269 S.W.2d 482, 487 (Tex. Civ. App.—El Paso 1954) *aff'd in part, rev'd in part*, 279 S.W.2d 848 (Tex. 1955).

[397] *Patton*, 279 S.W.2d at 854.

discussion of Texas statutory and case law and authorities from other jurisdictions,[398] the Court concluded "that Texas courts, under their general equity powers, may, in the more extreme cases of the general type of the instant one, decree liquidation and accordingly appoint a receiver . . . for this purpose [liquidation] or the less drastic purpose of 'rehabilitation.'"[399] The Court noted the

> experience of most lawyers having a substantial business practice will include instances, particularly in the case of small and closely held corporations . . . in which liquidation is about the only adequate remedy for the abused minority stockholder. On the other hand, we agree with the practically unanimous judicial opinion that liquidation of solvent going corporations should be the extreme or ultimate remedy, involving as it usually will, accentuation of the economic waste incident to many receiverships and most forced sales.[400]

"Wisdom would seem to counsel tailoring the remedy to fit the particular case."[401]

Therefore, the Supreme Court vacated the liquidation and receiver and ordered the trial court to substitute a new decree "which will probably give adequate protection to the respondents and at the same time afford both parties a chance to normalize their relationships."[402] The new decree would include a mandatory injunction requiring the corporation and "its dominant officer and stockholder to declare and pay at the earliest practical date a reasonable" and "substantial" dividend, the amount of which would be determined by the court and to pay dividends in the future in amounts "not clearly inconsistent with good business practice."[403] The trial court was to retain continuing jurisdiction for up to five years "for the more adequate and convenient protection of the rights of the respondents"[404] and to punish any "bad faith toward the decree or toward the respondents or either of them in their position of minority stockholders" both with the power of contempt and the option to order the liquidation of the corporation.[405] "We regard this latter provision as fair and even necessary, considering the malicious character of the misconduct heretofore involved and the consequent possibility of its repetition."[406]

The Supreme Court affirmed the denial of damages, but for a different reason than the trial court and the court of appeals. The Court held first that "there could be no even temporary devaluation of the stock in the ordinary sense, since it evidently never had a market," and there was no evidence of any price for which the plaintiffs could have sold the stock.[407] Furthermore, because the plaintiffs still owned their shares, the equitable relief fashioned by

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398 *Id.* at 854–56.
399 *Id.* at 856–57.
400 *Id.* at 857.
401 *Id.*
402 *Id.*
403 *Id.*
404 *Id.*
405 *Id.*
406 *Id.* at 858.
407 *Id.*

the court would likely make the plaintiffs whole.[408] The loss of dividends might have been a real loss had the plaintiffs sold their shares, but the order requiring payment of dividends would result in the plaintiffs receiving the withheld dividends, and any damage award would constitute a double recovery.[409] There being no actual damages, the award of exemplary damages was also disregarded.[410]

Post script: On remand, the trial court entered an order consistent with the Supreme Court's opinion and appointed a special master to determine the amount of the initial dividend.[411] Based on the special master's report, the trial court entered a judgment requiring the payment of $112,000 in dividends.[412] The defendant immediately appealed again, and the court of appeals affirmed and ordered that the dividend accrue interest until paid.[413] The Supreme Court refused the writ holding no reversible error.

### *3. Ritchie's Treatment*

The appellate opinions that developed the shareholder oppression doctrine in Texas looked chiefly to *Patton* as authority for the existence and flexibility of the courts' inherent general equitable powers to fashion and order the buy-out remedy.[414] The opinion was also very influential and widely cited in leading cases developing the shareholder oppression doctrine in other jurisdictions even prior to recognition of the doctrine in Texas.[415] In *Ritchie*, the Texas Supreme Court was at pains to re-interpret *Patton* so as to deny that the opinion supported the development of a shareholder oppression cause of action and to demonstrate that the opinion was in fact consistent with the *Ritchie* holding. The Court stated: "But *Patton* involved neither a claim for oppression nor a court-ordered buyout of stock."[416] That statement is essentially accurate. The specific claim in *Patton* that the Supreme Court upheld was "malicious suppression of dividends," which shareholder oppression cases have universally held to be a

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408 *Id.*

409 *Id.*

410 *Id.*

411 Patton v. Nicholas, 302 S.W.2d 441, 442 (Tex. Civ. App.—Waco 1957, writ ref'd n.r.e.).

412 *Id.*

413 *Id.* at 443.

414 *See, e.g.,* Kohannim v. Katoli, 440 S.W.3d 798, 816 (Tex. App.—El Paso 2013, pet. denied), *disapproved by*, Ritchie v. Rupe, 443 S.W.3d 856 (Tex. 2014) ("Wisdom to seem to counsel tailoring the remedy to fit the particular case."); Ritchie v. Rupe, 339 S.W.3d 275, 286–87, 289 (Tex. App.—Dallas 2011), *rev'd*, 443 S.W.3d 856 ("Texas law authorizes the trial court, in an appropriate case, to order a buyout of an oppressed minority shareholder as an equitable remedy for shareholder oppression."); Allchin v. Chemic, Inc., No. 14-01-00433-CV, 2002 WL 1608616, at *7 (Tex. App.—Houston [14th Dist.] July 18, 2002, no pet.); Davis v. Sheerin, 754 S.W.2d 375, 379–80, 383–84 (Tex. App.—Houston [1st Dist.] 1988, writ denied), *disapproved by*, *Ritchie*, 443 S.W.3d 856 (discussing *Patton* and concluding that Texas courts "may decree a buy-out in an appropriate case where less harsh remedies are inadequate to protect the rights of the parties.").

415 *See, e.g.,* Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 513, 514, 515 (Mass. 1975) (*Patton* cited for the proposition that "the power of the board of directors, controlled by the majority, to declare or withhold dividends and to deny the minority employment is easily converted to a device to disadvantage the stockholders."); Baker v. Com. Body Builders, Inc., 507 P.2d 387, 395 n.24, 396 n.27 (Or. 1973) (protecting the minority shareholder without appointing receiver); Gimpel v. Bolstein, 477 N.Y.S.2d 1014, 1022 (N.Y. App. Div. 1984) (court ordered mandatory injunction, with "dissolution being one of the remedies for contempt").

416 *Ritchie*, 443 S.W.3d at 876.

type of shareholder oppression,[417] but which did not involve the reasonable expectations analysis at issue in the oppression cases. Also, *Patton* did not order a buy-out, nor was one requested. The legal proposition for which the shareholder oppression cases cited *Patton* as authority was that the court had broad, general equitable powers to fashion an appropriate remedy and that the scope of those powers included the buy-out remedy. If the court has general equitable powers to liquidate a corporation, or to appoint a receiver to rehabilitate the corporation, or to order the controlling shareholder to vote to declare dividends and retain jurisdiction for five years to make sure that he did so, then a court could certainly order a corporation or a majority shareholder to purchase the minority shareholder's shares. Nothing in *Ritchie* questions that conclusion.

The difficulty for the *Ritchie* analysis was not *Patton*'s holding regarding the equitable powers to fashion a remedy, but the legal basis for imposing that remedy. Equitable remedies must be connected to a legal right and a cause of action for violation of that right.[418] What was the legal right and the cause of action in *Patton*? If *Patton* recognized the existence in Texas common law of a minority shareholder's legal right to dividends (under some circumstances) and the shareholder's individual standing to bring a lawsuit for the violation of that right, then Texas law would have already recognized a common-law cause of action for oppression[419] (of sorts), and the *Ritchie* court's public policy discussion as to whether it should create such a new cause of action[420] would have been superfluous. The majority in *Ritchie* solved that problem by assuming, with minimal analysis of the *Patton* opinion, that the plaintiff in Patton had brought a derivative claim for violation of the defendant's fiduciary duties to the corporation.[421] Does that conclusion follow from a fair reading of the *Patton* opinion?

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[417] *See, e.g.*, Redmon v. Griffith, 202 S.W.3d 225, 235 (Tex. App.—Tyler 2006, pet. denied), *disapproved by*, *Ritchie*, 443 S.W.3d 856 (malicious suppression of dividends constituted shareholder oppression); *Davis*, 754 S.W.2d at 382, *disapproved by*, *Ritchie*, 443 S.W.3d 856 (malicious suppression of dividends is a common squeeze-out technique); Morrison v. St. Anthony Hotel, 295 S.W.2d 246, 252 (Tex. Civ. App.—San Antonio 1956, writ ref'd n.r.e.).

[418] *See* Gibbons Mfg. Co. v. Milan, 17 S.W.2d 844, 846 (Tex. Civ. App.—Texarkana 1929, no writ) ("Consequently it is a well-established rule that, in order to authorize the appointment of a receiver, it is essential that there shall be at the time of the appointment a suit pending in which relief other than the mere appointment of the receiver is sought.").

[419] The *Ritchie* opinion dismisses the notion that any such claim exists: "The *Patton* opinion uses the word 'oppression' only once, when describing the kind of future conduct that a rehabilitative receivership may be designed to prevent, in the context of a New Jersey case involving fraud claims by one corporate director against two other corporate directors." *Ritchie*, 443 S.W.3d at 884 n.48. However, the Court ignores the fact that *Cates* uses the term "oppression" three times, all clearly referencing an existing cause of action. *See* Cates v. Sparkman, 11 S.W. 846, 849 (Tex. 1889). The reference in *Patton* is not a quote of some New Jersey opinion, as the *Ritchie* opinion seems to imply, but a clear statement by the *Patton* Court of an appropriate basis for the use of the court's equitable powers:

> Wisdom would seem to counsel tailoring the remedy to fit the particular case. As suggested in *Laurel Springs Land Co. v. Fougeray*, equity may, by a combination of lesser remedies, including exercise of its practice of retaining jurisdiction for supervisory purposes and reserving the more severe measures as a final weapon against recalcitrance, accomplish much toward avoiding recurrent mismanagement or oppression on the part of a dominant and perverse majority stockholder or stockholder group.

Patton v. Nicholas, 279 S.W.2d 848, 857 (Tex. 1955).

[420] *Ritchie*, 443 S.W.3d at 877–91.

[421] *Id.* at 884 ("we treated that claim as being brought by the shareholders on behalf of the corporation").

The *Ritchie* Court argues that "the cases on which we relied [in *Patton*]"—*Cates v. Sparkman*[422] and *Becker v. Directors of Gulf City Street Railway & Real–Estate Co.*[423]—"indicate that we treated that claim as being brought by the shareholders on behalf of the corporation."[424] The *Patton* opinion refers to *Cates* and *Becker* twice: first, as authority for the proposition "Undoubtedly the malicious suppression of dividends is a wrong akin to breach of trust, for which the courts will afford a remedy. A minority stock interest is far from 'change left on the counter'-to quote the petitioner's own written comment about the settlement,"[425] and, second, noting that the language in *Cates* and *Becker* "seems to recognize a minority right to receivership in cases of gross or fraudulent mismanagement, although without particular reference to whether liquidation or something else is to follow."[426] Neither reference gives the slightest hint that the action in *Patton* was brought derivatively or needed to be. *Cates* has already been dealt with at length. It was not a derivative action, although it discussed derivative actions. Its holding was not based on the failure to bring the claim derivatively but the failure to allege misconduct that violated a duty to the individual shareholder. *Cates* acknowledged that minority shareholders had the ability both to bring claims on behalf of the corporation in a representative capacity, when it refused to do so, and in certain instances to bring their own claims against the company to vindicate violation of their own rights when they otherwise would be left without a remedy. No language in *Cates* mentions suppression of dividends, breach of trust, or receivers, but the overall tenor of the case is clearly that minority shareholder rights are valuable and will be protected by the law.

*Becker* is a different kind of case and warrants close scrutiny given the importance that *Ritchie* placed on that opinion in interpreting *Patton*. *Becker* was brought by 33 shareholders of the Gulf City Street-Railway and Real-Estate Company, of Galveston, Texas.[427] The lawsuit alleged that the directors of their company had illegally consolidated that corporation into the Galveston City Railroad Company, also of Galveston, and "by means of which they had fraudulently and unlawfully seized and taken possession of the rights, properties, and franchises of the Gulf City Street-Railway and Real-Estate Company [and had] appropriated and converted the same to their own use and benefit . . . contrary to law and the terms and conditions of the charter."[428] The plaintiffs sought to unwind the merger, to restore the property to their original corporation, and to have a receiver appointed to obtain and restore the corporation's property. The original and amended petition sought only relief on behalf of the

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422 *Cates*, 11 S.W. 846.

423 15 S.W. 1094 (Tex. 1891).

424 *Ritchie*, 443 S.W.3d at 884 (citing *Patton*, 279 S.W.2d at 854).

425 *Patton*, 279 S.W.2d at 859. The "change on the counter" quote does not come from either opinion but from a letter written by the defendants which was quoted by the court of appeals:

> You can also believe me that I paid them plenty good money. In fact, enough that as the business was incorporated they had better than $100,000.00 worth of stock due them, although a lot of my $75,000.00 bait money to save the business went into their stock. On the other hand, and what they could not figure in advance was that the $112,000.00 worth of stock they received could be change that they left on the counter.

Patton v. Nicholas, 269 S.W.2d 482, 484 (Tex. Civ. App.—El Paso 1954), *rev'd in part on other grounds*, 279 S.W.2d 848.

426 *Patton*, 279 S.W.2d at 854.

427 *Becker*, 15 S.W. at 1094.

428 *Id.* at 1094–95.

plaintiffs individually, but a second amended petition added claims on behalf of the original corporation.[429] The Texas Supreme Court noted that "the petition was of a somewhat dual character. The plaintiffs asked for the receiver in their own rights as stockholders, and for a recovery for the benefit of the company. This latter ground was set up to obviate the objections made by the demurrers which were sustained in this particular to the first amended petition."[430] The claims for recovery on behalf of the corporation were clearly derivative claims, but the request for a receivership was at first an individual claim and appears to have remained so (in the alternative). The defendants argued that the derivative claims were time-barred because the second amended petition was filed more than two years after the merger. The Supreme Court held, in essence, that the second amended petition related back to the original petition because the relief sought by the plaintiffs always recognized the rights of the original corporation to its property and had sought a receiver to restore that property to the original corporation from the consolidated corporation.[431] "Their avowed and manifest object was to restore the company to its original charter basis, and to the enjoyment and use of its property and franchises in accordance with the charter."[432] Therefore, the receivership sought in *Becker* was very different from that sought in *Patton*, which was for the purpose of liquidation and thus adverse to the corporation. In addition to the holding under the relation back doctrine, the *Becker* Court also noted that limitations would have been tolled, analogizing the corporation to a trustee for its shareholders: "It may also be noted that in cases of trusts and appropriation of trust property the statute of limitation will not begin to run until the repudiation of the trust is manifest, nor where the fraud of the trustees is concealed, so that it cannot be discovered by reasonable diligence."[433] Twenty-three years later, as will be discussed in much greater depth below, the Texas Supreme Court made this implicit comparison of corporation to trustee explicit in *Yeaman v. Galveston City Co.*,[434] in which the Court held that the relationship between corporation and shareholders "has all the nature of a direct trust,"[435] and that the corporation is held to many of the same duties as a trustee, including that "statutes of limitation have no application until there is a clear and unequivocal disavowal of the trust, and notice of it brought to the cestui que trust."[436] Therefore, *Becker* does mention the concept of trust duties and clarifies the context for *Patton*'s citation of that case in support of the proposition that "malicious suppression of dividends is a wrong akin to breach of trust."[437]

Did the plaintiffs in *Patton* plead derivative claims? Absolutely nothing in either the reported court of appeals opinion or the Supreme Court opinion states that any claim was brought derivatively or on behalf of the corporation. Neither opinion states that any of the duties at issue were duties owed to only the corporation, as opposed to the minority shareholders. However, there is also no clear statement to the contrary. In the court of appeals,

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[429] *Id.* at 1096 ("second amended petition the plaintiffs seek to recover for the use of the company, but in their own names, and as share-owners, whereas in the first they asked the judgment in their own right as shareholders").

[430] *Id.* at 1097.

[431] *Id.* at 1096–97.

[432] *Id.* at 1097.

[433] *Id.* (relying on two express trust cases, Turner v. Smith, 11 Tex. 620 (1854); Calhoun v. Burton, 64 Tex. 510 (1885)).

[434] Yeaman v. Galveston City Co., 167 S.W. 710 (Tex. 1914).

[435] *Id.* at 723.

[436] *Id*. at 723–24.

[437] Patton v. Nicholas, 279 S.W.2d 848, 854 (Tex. 1955).

the defendant challenged the "failure of the trial court to segregate the two causes of action, alleging that appellees sued individually and on behalf of the corporation,"[438] but it is unclear whether this was merely the defendant's characterization or was actually how the causes of action were actually pleaded. The court of appeals rejected any error as harmless because "the entire controversy is interwoven."[439] The Supreme Court's opinion stated that the minority shareholders' case "must be one for mismanagement of the corporation or misconduct in the handling of its affairs to [the minority shareholders'] prejudice or that of the corporation itself or both,"[440] leaving open the possibility that the claims relating to mismanagement were either entirely direct or entirely derivative or a mixture, and never indicating that it made any difference one way or the other. Claims for mismanagement (assuming they survive the business judgment rule) do ordinarily belong to the company and may only be asserted by shareholders derivatively.[441] So it is possible that the damages claim for mismanagement was presented derivatively. But what is clear beyond cavil, however, is that the plaintiffs in *Patton* did assert the individual claims, and what matters for this analysis is whether the Supreme Court imposed the mandatory injunction to pay dividends on the basis of those individual claims or solely on the basis of a derivative claim.

The *Ritchie* Court characterizes the plaintiff's claims as "a suit in which a corporation's two minority shareholders alleged that Patton—the corporation's majority shareholder, president, and controlling board member—committed fraud and breached his duties to the corporation."[442] The fraud claim was clearly an individual claim.[443] That claim was based on the defendant's inducing the plaintiffs to incorporate their partnership, concerned only pre-incorporation events, and had nothing to do with duties to the corporation. The relief that the plaintiffs sought on their fraud claim was a receivership to liquidate the corporation. An action for liquidating receiver is an individual action brought by a shareholder, not a derivative action.[444] A corporation may not seek a liquidating receivership for itself,[445] nor may its directors seek one on its behalf,[446] nor may a shareholder seek one derivatively.[447] The *Patton*

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[438] *Id.*

[439] *Id.*

[440] *Id.* at 852.

[441] Wingate v. Hajdik, 795 S.W.2d 717, 718 (Tex. 1990).

[442] Patton v. Nicholas, 269 S.W.2d 482, 484 (Tex. Civ. App.—El Paso 1954), *rev'd in part on other grounds*, 279 S.W.2d 848.

[443] Sherman v. Triton Energy Corp., 124 S.W.3d 272, 282 (Tex. App.—Dallas 2003, pet. denied).

[444] *See* Hammond v. Hammond, 216 S.W.2d 630, 633 (Tex. Civ. App.—Fort Worth 1949, no writ) ("Our conclusion, after considering many of the authorities referred to, is that a court of equity may properly take jurisdiction to wind up the affairs of a corporation and sell and distribute its assets *at the suit of a minority stockholder* on the ground of dissensions among the stockholders, but that it is only an extremely aggravated condition of affairs that will warrant such drastic action, and that the court will follow such a procedure only when it reasonably appears that the dissensions are of such nature as to imperil the business of the corporation to a serious extent and that there is no reasonable likelihood of protecting the rights of the minority stockholder by some method short of winding up the affairs of the corporation.") (emphasis added).

[445] A court "may appoint a receiver for a corporation on the petition of one or more stockholders of the corporation." TEX. CIV. PRAC. & REM. CODE ANN. § 64.002(b) (West 1997). However, it "may not appoint a receiver for a corporation, partnership, or individual on the petition of the same corporation, partnership, or individual." *Id.* at (a). *See also* Floore v. Morgan, 175 S.W. 737, 738, 740 (Tex. Civ. App.—Fort Worth 1915, no writ) ("[T]he company itself is prohibited from suing for the appointment of a receiver").

[446] *Floore*, 175 S.W. at 740 (The suit by the directors of the company was necessarily a suit in behalf of the

Court rejected the fraud claim as a basis for the receivership[448] and undertook to determine whether a court had the equitable power to appoint a liquidating receiver on the basis of the remaining claims. The Texas authorities cited by the Court suggested the availability of a receiver in "extreme cases of mismanagement."[449] However, the Court ultimately held that there was no evidence to support the claim of mismanagement.[450] Therefore, the specific claims that the Supreme Court noted may have been brought derivatively were emphatically not the basis of the equitable relief awarded.

Turning to the dividends claim, the Court found authority in other jurisdictions to appoint a receiver in egregious cases of withholding of dividends.[451] The principal cases relied on in the *Patton* opinion were the Michigan Supreme Court case of *Miner v. Belle Isle Ice Co.*[452] and the Fourth Circuit case of *Tower Hill-Connellsville Coke Co. of W. Virginia v. Piedmont Coal Co*.[453] Neither of these cases were brought on behalf of the corporation. In *Miner*, a minority shareholder sued the corporation and the remaining shareholders seeking a receiver to wind up the affairs of the company following seven years of receiving no dividends, while the remaining shareholders received large salaries and rents from the corporation.[454] The Court's opinion makes absolutely clear that the party harmed was the minority shareholder, not the corporation, and the party for whom the relief was granted was the minority shareholder, not the corporation:

> Who has any right to complain if ample and complete justice is awarded to Miner [the minority shareholder]? Who should be permitted to stand between him and an

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company, and if the company itself is prohibited from suing for the appointment of a receiver, the same inhibition applies to the directors of the company acting in its behalf.).

447 *See* Johnson *ex rel.* MAII Holdings, Inc. v. Jackson Walker, L.L.P., 247 S.W.3d 765, 771 (Tex. App.—Dallas 2008, pet. denied). ("[B]ecause the court may not appoint a receiver for a corporation based on the corporation's own request, the trial court did not err in denying the request for a receiver over MAII made by a shareholder seeking to act on MAII's behalf.").

448 Patton v. Nicholas, 279 S.W.2d 848, 852 (Tex. 1955).

449 *Id.* at 854 (citing Gibbons Mfg. Co. v. Milan, 17 S.W.2d 844, 847 (Tex. Civ. App.—Texarkana 1929, no writ) (appointment of a receiver "only when necessary to protect the rights of creditors and the minority stockholders.")); Prairie Lea Prod. Co. v. Tiller, 286 S.W. 638, 641 (Tex. Civ. App.—Austin 1926, no writ) (noting "trend of modern authority favors the inherent power of the court in a proper case to place the affairs of a corporation, at the suit of stockholders, in the hands of a receiver, when the officials are guilty of fraud or neglect"); Falfurrias Immigration Co. v. Spielhagen, 129 S.W. 164, 169 (Tex. Civ. App. 1909, no writ) (power to appoint a receiver to prevent majority from diverting "its entire business to the other concerns in which they are interested, and thus destroy the value of plaintiff's stock"); *Hammond*, 216 S.W.2d at 632 (noting "the courts have been comparatively liberal in the appointment of a receiver of a corporation, even though it is a solvent and going concern, where there are such dissensions among the stockholders, directors, or officers that the corporation cannot successfully carry on its corporate functions, imminent danger of loss of assets is threatened, and no other remedy appears to be adequate"). None of these cases appear to have been brought derivatively, with the possible exception of *Falfurrias Immigration Co. v. Spielhagen* in which the plaintiff brought the suit both "as a shareholder in said corporation, and in its behalf, and for its benefit." 129 S.W. at 168.

450 *Patton*, 279 S.W.2d at 853.

451 *See id.* at 855–56.

452 Miner v. Belle Isle Ice Co., 53 N.W. 218, 224 (Mich. 1892).

453 Tower Hill-Connellsville Coke Co. v. Piedmont Coal Co., 64 F.2d 817, 829 (4th Cir. 1933).

454 *Miner*, 53 N.W. at 223.

> adequate remedy? This corporation has utterly failed of its purpose, not because of matters beyond its control, but because of fraudulent mismanagement and misappropriation of its funds. Complainant [the minority shareholder] has a right to insist that it [the corporation] shall not continue as a cloak for a fraud upon him, and shall no longer retain his capital to be used for the sole advantage of the owner of the majority of the stock, and a court of equity will not so far tolerate such a manifest violation of the rules of natural justice as to deny him the relief to which his situation entitles him. I think a court of equity, under the circumstances of this case, in the exercise of its general equity jurisdiction, has the power to grant to this complainant ample relief, even to the dissolution of the trust relations. Complainant is therefore entitled to the relief prayed. A receiver will be appointed, and the affairs of this corporation would up.[455]

This point was even more pronounced in *Tower Hill*, where the corporation was the only defendant in a case brought by individual shareholders seeking a liquidation.[456] On appeal, the directors, whose withholding of dividends resulted in the receivership, argued that they were necessary and indispensable parties and should have been joined—which would have resulted in defeating the federal court's diversity jurisdiction—and the Fourth Circuit held "the defendant corporation itself was the only indispensable party."[457] The court stated that the lawsuit was "an earnest effort by these plaintiffs to rescue at least some part of their investment from an arbitrary, unjust, and tyrannical domination by a ruthless majority—a majority that acts entirely without regard to that trust relationship that exists between a controlling majority and a minority in a stock company."[458] The claim asserted was clearly a claim by the individual shareholders against, not on behalf of, the corporation:

> Against the corporate defendant, the plaintiff sought an annulment of its charter, with incidental injunctional relief pending a hearing and decision of that main issue. This was an attack upon the existence of the corporation in which it was vitally interested, which it had to defend, and to which the stockholders and directors were in no sense necessary parties. It was clearly separable from the claim of damages against the individual defendants for acts which they did as directors and stockholders of the old corporation, in which the new corporation was not interested, and to which it could not be required to respond.
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> In this case, the action of which the plaintiffs have reason to complain is the action of the corporation. This action, while controlled by the majority of the stockholders, is

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455 *Id*. at 224.

456 *See Tower Hill-Connellsville Coke Co.*, 64 F.2d at 827 ("If a majority of the shareholders or the directors of a corporation wrongfully refuse to declare a dividend and distribute profits earned by the company, any shareholder feeling aggrieved may obtain relief in a court of equity.").

457 *Id.* at 823.

458 *Id.* at 824.

> the act of the corporation, and not their action, and relief is asked against the corporation and not against them. No rights of theirs will be affected by the action of the court, but only the rights of the corporation. After dissolution is decreed, they can come in and receive the portion of the assets belonging to them and make themselves parties to the suit pro hac vice, but this does not defeat the jurisdiction, for this is what happens in every receivership case.[459]

Furthermore, under Texas law, the right to dividends is a right belonging to the individual shareholder, not the corporation. In *Moroney v. Moroney*,[460] the court held:

> Indeed, in every profitable corporate venture, the rights of the stockholder are of great importance, and at all times will be properly protected, whether in a court of law or equity, according to the exigencies of the situation. The chief value of corporate stock is its right to receive dividends. So important is this right that courts of equity will, in a proper case, compel a payment of dividends.[461]

Dividends once declared are a debt that the corporation owes to the individual shareholder.[462] An action to compel the declaration of dividends is based on the shareholder's fundamental right to share in the net profits of the corporation, a right incident to the ownership of his stock and belonging to the shareholder individually.[463] When dividends are suppressed, the injured party is the shareholder, and that injury is separate and distinct from any injury that the corporation might suffer arising from the same conduct.[464] Even if the corporation had its own claim for breach of the directors' duties, that claim would not be the same claim and would not affect the existence of the shareholder's claim for his own individual injury.[465] Therefore, the action to compel declaration of dividends is an action brought by the individual shareholder, not by the corporation or on its behalf.[466]

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[459] *Id.* at 825.

[460] Moroney v. Moroney, 286 S.W. 167 (Tex. Comm'n App. 1926, judgm't affirmed).

[461] *Id.* at 169; *see also* Farrington v. Tennessee, 95 U.S. 679, 687 (1877) (listing among the fundamental aspects of share ownership the entitlement "to share in the dividends and profits.").

[462] Keller v. Keller, 141 S.W.2d 308, 311 (Tex. 1940) ("When dividends are declared the corporation becomes indebted to the stockholders for the amounts of their respective shares, and are not subject to change merely at the choice of a stockholder.").

[463] *See* Knapp v. Bankers Sec. Corp., 230 F.2d 717, 721 (3d Cir. 1956) ("The right to dividends is an incident of the ownership of stock. The fact that the distribution of profits cannot ordinarily be enforced until after a dividend has been declared does not detract from the shareholders' fundamental right to share in the net profits of the corporation. This right is the basis of his suit to compel the declaration of dividends.").

[464] *See id.* ("If the directors have wrongfully withheld the declaration of dividends the shareholder is the injured party. He shows an injury to himself which is quite apart from any which the corporation might be thought to suffer.").

[465] *See id.* ("Even if the corporation might under some circumstances have a right of action that fact would not affect the authority of its shareholders to enforce by suit their personal and individual rights to the declaration of a dividend.").

[466] *See* Morrison v. St. Anthony Hotel, 295 S.W.2d 246, 250 (Tex. Civ. App.—San Antonio 1956, writ ref'd n.r.e.) ("Generally, it is the corporation and not the stockholders which must redress wrongs which weaken corporate values. But in a proper case, where a majority stockholder has abused its discretion and has maliciously suppressed the payment of dividends, a stockholder may assert a cause of action for damages and may compel the declaration of dividends."). *See also* Tankersley v. Albright, 80 F.R.D. 441, 445 (N.D. Ill. 1978) ("[T]he now prevailing view is that

The conclusion of the *Patton* Court was that the remedy of a liquidating receiver, a remedy that the corporation could not request and to which it would be the adverse party, could be awarded for the violation of the rights of the minority shareholder to receive dividends, a right that the corporation does not have. The order to pay dividends, an order no one in *Patton* requested and which would not in any event have benefitted the corporation, was made within the Court's equitable power to fashion a less drastic remedy as a substitute for the liquidating receivership. The judgment rendered by the trial court, which the Supreme Court affirmed as modified, was against the majority shareholder *and* the corporation, not in favor of the corporation.[467] The injunction that the Supreme Court ordered on remand was against the majority shareholder *and* the corporation, not in favor of the corporation.[468] The relief granted in the new order did not benefit the corporation in any way, but provided specific and substantial benefits to the individual minority shareholders. The trial court was ordered to retain jurisdiction for up to five years and to liquidate the corporation if the majority shareholder "in any manner operated with bad faith toward the decree or toward the respondents or either of them in their position of minority stockholders."[469] The relief granted in *Patton* was not on the basis of a derivative claim, and the *Ritchie* dissent properly took the majority to task for attempting to rewrite the opinion.[470]

In its effort to support the proposition that the derivative claim is sufficient to address most of the evils that the shareholder oppression doctrine sought to remedy[471] and to claim that *Patton* is consistent with its holding, the majority opinion in *Ritchie* goes so far as to misstate the liability holding in *Patton*, claiming that *Patton* held "majority shareholder liable when he used 'his control of the board for the malicious purpose of . . . preventing dividends and otherwise lowering the value . . . of the stock of the [minority shareholders].'"[472] The language quoted was not the holding of *Patton*; it was a determination that evidence was sufficient to support the finding that the defendant had used his "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.[473] The legal remedy that this finding supported was not liability of the majority shareholder to the corporation for such malicious activity toward the corporation, but an injunction against both the majority shareholder and the corporation compelling the corporation to pay dividends to the shareholders—backed up by the penalty of

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an action to compel a declaration of dividends is personal, not derivative, because dividends are an incident of stock ownership, the shareholder is the injured party when a dividend is wrongfully withheld and finally because only the shareholder will gain by a judgment for plaintiff."); Doherty v. Mut. Warehouse Co., 245 F.2d 609, 612 (5th Cir. 1957) ("A stockholder suing to compel the corporation to declare a dividend is enforcing a right common to himself and the other stockholders against the corporation, rather than a derivative right."); *Knapp,* 230 F.2d at 721 ("[A] shareholders' suit to compel the declaration of a dividend must be regarded as brought to vindicate a primary and personal right of the shareholders and not to enforce a secondary right derived from the corporation as the real party in interest. We are compelled to reach this conclusion when we consider who is the injured party, the shareholder or the corporation, and who will be benefited if the action is brought to a successful conclusion.").

467 Patton v. Nicholas, 279 S.W.2d 848, 857 (Tex. 1955).

468 *Id.* at 857–58.

469 *Id.* at 858.

470 *See* Ritchie v. Rupe, 443 S.W.3d 856, 898 (Tex. 2014) (Guzman, J., dissenting).

471 *Id.* at 887.

472 *Id.* at 884 (citing *Patton*, 279 S.W.2d at 853). It is also important to note that the Supreme Court held that there was no evidence that the stock value was actually harmed. 279 S.W.2d at 858.

473 *Patton*, 279 S.W.2d at 853.

liquidating the corporation if the "corporation has been in any manner operated with bad faith toward the decree or toward the respondents or either of them in their position of minority stockholders."[474]

In fairness to the majority in *Ritchie*, however, perhaps we should assume that description of *Patton* was not an intentional mischaracterization of the opinion but an explanation of how the principles laid down in *Patton* should be applied going forward—that *Ritchie*'s treatment of the *Patton* opinion was not descriptive but prescriptive. Perhaps the *Ritchie* majority meant that the claims in *Patton* should have been derivative claims, that the holding was otherwise correct but should have made clear that such a claim must be prosecuted derivatively (again, in fairness, a point apparently not raised by any party before the Supreme Court in *Patton*). If that is true, then one would have to conclude that it would have to have been a very weird derivative claim indeed. In arguing that the derivative action remedy is sufficient to protect shareholders from wrongful withholding of dividends, the *Ritchie* Court stated: "*Patton* demonstrates that when a corporate director violates the duty to act solely for the benefit of the corporation and refuses to declare dividends for some other, improper purpose, the director breaches fiduciary duties to the corporation, and the minority shareholders are entitled to relief, either directly to the corporation or through a derivative action."[475] Further, the *Ritchie* opinion argued: "As *Patton* itself demonstrates, the very conduct the dissent claims does not harm the corporation in fact can give rise (and has given rise in the past) to a breach-of-fiduciary-duty claim against the corporate controller who engaged in such conduct to benefit himself at the expense of the corporation,"[476] because "refusal to pay dividends, paying majority shareholders outside the dividend process, and making fire-sale buyout offers certainly can harm the corporation, for instance, by lowering the value of its stock."[477] The difficulty in understanding that proposition is that the corporation, as such, does not have any claim or interest in the value of its shares because the corporation does not own its own stock. The shareholders own the stock, and the corporation owns what the stock represents. When a shareholder sells stock, the shareholder keeps the money, and the corporation is unaffected by any gain or loss that the shareholder realizes on the transaction as a result of changes in the value of the shares. When action is taken to reduce the value of shares as to the shareholder, the corporation does not have a claim. There is no corporate remedy for devaluation of its shares. The theory of cases like *Commonwealth of Massachusetts v. Davis* is that when corporate property is damaged or stolen, incidentally resulting in the loss of value to the shares, then the corporation has a remedy for the harm that caused the devaluation,[478] but the measure of damages is for the actual harm inflicted on the corporation (lost profits, property damage, etc.), not the resulting depreciation in the value of the shares suffered by the shareholders.[479] Moreover, from the corporation's perspective, whether profits remain in the corporation or are distributed to the shareholders as dividends is immaterial—arguably, the corporation as an entity would always be far better off to stockpile its cash resources and never

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474 *Id.* at 858.

475 *Ritchie*, 443 S.W.3d at 884. It is a complete mystery how a court would order such relief "directly to the corporation" in a dividend case. Would the court order the corporation to pay dividends to itself?

476 *Id.* at 885 n.53.

477 *Id.* at 893.

478 Massachusetts v. Davis, 168 S.W.2d 216, 226 (Tex. 1942).

479 *Id.*

declare dividends.[480] So far from holding that the injunction remedy was available because of harm done to the corporation from loss of value of the corporation's stock, the *Patton* Court expressly held that the value of the shares never diminished, not even temporarily.[481] The *Patton* Court held that there was no evidence of damage to the corporation in any regard.[482] There is no question that the majority shareholder in *Patton* breached his duty to act solely for the benefit of the corporation by refusing to declare dividends for reasons having nothing to do with the corporation,[483] but a breach of fiduciary duty claim requires resulting harm to the corporation or benefit to the defendant as well as a breach of duty to be actionable.[484] Leaving corporate profits in the corporation might harm the minority shareholders, but it would neither harm the corporation nor necessarily benefit the majority shareholder. Moreover, if the suit is successful, the corporation does not benefit from the relief; rather, the minority shareholder benefits at the expense of the corporation when the corporation pays out its cash reserves.[485]

Taking the *Ritchie* opinion at face value, then the Court must have been holding that, going forward, Texas law works something like this: Party A (majority shareholder controlling the board) owes duties to Party B (corporation) but not to Party C (minority shareholder). If Party A commits an act that is a breach of duty to Party B that harms Party C but does not harm Party B, then Party B has a cause of action against Party A but no damages, and Party C has damages but no cause of action. Nevertheless, Party A may be sued by or on behalf Party B for the harm done to Party C, and the court may award an equitable remedy compensating Party C that does not benefit Party B. If so, then *Ritchie* has fundamentally changed the nature of derivative suits from a vehicle by which the shareholder may obtain relief for the corporation to one in which the shareholder may obtain relief for himself using the corporation as a proxy. Take a minority shareholder, who is frozen out of a company by the majority's cutting off all economic benefit for a malicious reason and not for the good of the company. Under *Ritchie*'s reading of *Patton*, the aggrieved minority shareholder could bring a derivative action based on the breach of the duty to act solely for the benefit of the company, offer no

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> The corporation is not injured by the retention of profits among its assets which might be distributed, and thus become the private, separate property of the stockholders. On the contrary, the corporation is enriched. The object of this suit is not to compel directors to do or refrain from doing something for the benefit of the corporation, but to do something for the benefit of the complaining stockholder which may be disadvantageous to the corporation.

Knapp v. Bankers Sec. Corp., 230 F.2d 717, 722 (3d Cir. 1956) (quoting Stevens v. U.S. Steel Corp. 59 A. 905, 906 (N.J. Ch. 1904)).

481 Patton v. Nicholas, 279 S.W.2d 848, 858 (Tex. 1955).

482 *Id.* at 853 ("we find no evidence otherwise that it was damaged").

483 *See* Ritchie v. Rupe, 443 S.W.3d 856, 884 (Tex. 2014).

484 Priddy v. Rawson, 282 S.W.3d 588, 599 (Tex. App.—Houston [14th Dist.] 2009, pet. denied).

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> It is equally clear that the successful outcome of a suit such as the one before us will benefit only the shareholders. The defendant corporation suggests that such an action is for the benefit of the corporation in the sense that it is in the interest of the corporation that it be well managed and have a good dividend policy. We do not think that this highly theoretical benefit can outweigh the obvious disadvantage to the corporation of losing the cash which if not distributed to the shareholders would remain available for use in the conduct of the corporate business. Certainly it cannot be a benefit to a corporation, as such, to lose assets, even to its shareholders.

*Knapp*, 230 F.2d at 722.

evidence of any harm to the company,[486] and receive equitable relief which provides significant, specific benefits to the minority shareholder and no benefits to the company. Depending on the case, the shareholder might receive a mandatory injunction requiring the company to pay dividends in an amount set by the court and five years of court supervision to prevent any act of bad faith by the majority shareholder toward the minority shareholder. Or, again depending on the case, the court might use its general equitable power to fashion a different, more appropriate remedy—say, a compulsory buy-out of the minority shareholder's stock at a fair value determined by the court. If that is really what the *Ritchie* opinion means, then the shareholder oppression doctrine did not go away after all. Almost every the shareholder oppression case decided over the last 30 years was correct, save for one relatively minor thing: For some reason, those claims needed to be brought procedurally as derivative actions, instead of direct claims—with the added benefit that attorney's fees will now be recoverable from the corporation whenever the plaintiff is successful.[487] If that is what the *Ritchie* decision really means,[488] then the pronouncements of the death of the shareholder oppression doctrine were greatly exaggerated.

It would be far better to read *Patton* as it is actually written and recognize that in certain limited situations, minority shareholders have protectable legal interest arising from the fact that they are shareholders and independent of any officer/director duties to the corporation, and Texas common law already recognizes, and has for over a century, that equitable relief is available in an action brought directly by the shareholder in his individual capacity for his own benefit to protect those interests. The cause of action affirmed in *Patton* is precisely the kind of claim anticipated by *Cates*—a claim for "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 [an individual, equitable remedy], would leave the latter remediless."[489]

Finally, it is worth noting that the majority shareholder in *Patton* was something of an underachiever when it comes to shareholder oppression. Like the majority shareholder in *Boehringer*, he acted out of malicious motives specifically aimed at harming and squeezing out the minority shareholders. He made their lives hell and forced them to resign, cutting off all economic benefits of share ownership, and refused to declare dividends. However, the *Patton* majority shareholder left all the profits in the company where they were available for later distribution. In *Boehringer*, the majority shareholder made sure the profits went into his pocket by increasing his salary. But for the existence of some duty to the minority shareholder, the fact that the majority shareholder is acting for the purpose of harming the minority

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[486] *Patton*, 279 S.W.2d at 853 ("we find no evidence otherwise that it was damaged").

[487] TEX. BUS. ORGS. CODE ANN. § 21.561(b)(1) (West 2006).

[488] The Supreme Court invited exactly this conclusion in its per curiam opinion remanding *Cardiac Perfusion Services, Inc. v. Hughes*. See 436 S.W.3d 790, 792 (Tex. 2014) (per curiam) ("When we declined in *Ritchie* to follow the Texas courts of appeals' decisions recognizing a common-law cause of action for shareholder oppression, we did so in part because of the adequacy of other existing legal protections. We noted that a minority shareholder in a closely held corporation may recover equitable relief, in some cases individually as well as on behalf of the corporation, through a derivative action for breach of fiduciary duties under section 21.563(c) of the Business Organizations Code.").

[489] Cates v. Sparkman, 11 S.W. 846, 849 (Tex. 1889).

shareholder—the deciding factor in *Patton*[490] —such evil intent could not be actionable. After all, the decision to declare or not to declare dividends is something that the majority "has the right to do"[491] and is accorded heavy deference by the courts,[492] and of what legal significance can it possibly be that the majority shareholder is acting out of desire to harm someone to whom he owes no legal duty? The minority shareholder in either case might be able to bring a derivative action to restore to the corporation property wrongfully taken, but that would ignore the need for prospective relief due to "the malicious character of the misconduct heretofore involved and the consequent possibility of its repetition" that the *Patton* Court found so compelling.[493] The legal rights of minority shareholders, the legal duties owed to them, and the legal and equitable remedies available to them, that are already firmly established in Texas common law and are available for development and extension by our courts, may not be as flexible as the "reasonable expectations" approach under the shareholder oppression doctrine, but they are substantial and offer Texas courts the opportunity accept the invitation made by the *Ritchie* Court to develop meaningful protections that fill in the gaps left by the *Ritchie* opinion through development of traditional, established causes of action and remedies that "already exist.'[494]

### D. Re-examining *Morrison v. St. Anthony Hotel*

*Morrison v. St. Anthony Hotel, San Antonio*,[495] was a case decided one year after *Patton*, which relied on *Patton* and applied exactly the same cause of action recognized in *Patton*, and was a case on which the Supreme Court refused the writ for no reversible error.[496]

If the opinion in *Patton* was at all ambiguous as to whether there were any derivative claims in the pleadings, the *Morrison* opinion was not. The plaintiff was a former stockholder in The St. Anthony Hotel, and sued that corporation, together with its directors and the Pan American Hotel Company, which owned the majority of the stock of The St. Anthony, for malicious suppression of dividends.[497] In 1948, the plaintiff and Pan American had been engaged in another suit, which they settled by executing a written settlement agreement.[498] The settlement provided for the formation of The St. Anthony Hotel corporation to operate a hotel property owned by Pan American, which would hold 52% of the stock in the new corporation.[499] The minority shareholders, including the plaintiff, were to receive dividends of all the net earnings of the new corporation up to $130,000.[500] The stock certificates specifically required the directors to declare dividends of all net earnings to the shareholders each year.[501] The settlement agreement also provided that Pan American would have a continuing option to

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490 *Patton*, 279 S.W.2d at 858.

491 *Cates*, 11 S.W. at 850.

492 ARGO Data Res. Corp. v. Shagrithaya, 380 S.W.3d 249, 270 (Tex. App.—Dallas 2012, pet. denied).

493 *Patton*, 279 S.W.2d at 858.

494 Ritchie v. Rupe, 443 S.W.3d 856, 879 (Tex. 2014).

495 295 S.W.2d 246 (Tex. Civ. App.—San Antonio 1956, writ ref'd n.r.e.).

496 *Id.* at 250.

497 *Id.* at 247.

498 *Id.* at 248.

499 *Id.*

500 *Id*.

501 *Id.*

purchase the minority stock at a price to be determined by the company auditor.[502]

In 1952, Pan American exercised its option to buy the minority stock.[503] Morrison then filed suit, claiming that the option was invalid and that he still owned the stock, and claiming breach of contract for failure to pay dividends and breach of trust for conduct by the majority stockholder causing "the malicious depression [] of his dividends and stock values."[504] The court of appeals specifically noted that the lawsuit included claims for "damages which he claims he individually suffered by reason of certain mismanagement practices and a breach of trust on the part of the majority stockholder, which conduct resulted in depressing his dividends and stock values."[505]

The ownership issue was severed and tried first, with the trial court holding that the plaintiff no longer owned his stock and upholding the valuation set by the auditor on which the purchase option had been exercised.[506] That holding was affirmed on appeal.[507] The case then went forward on the dividend claims. The trial court sustained a plea of res judicata and a special exception which stated that plaintiff had failed to assert a cause of action.[508] The court of appeals rejected the res judicata holding on the grounds that the dividend claims were not part of the severed proceeding.[509] The court of appeals reversed the dismissal of the contract claim, holding that the minority shareholders were contractually entitled to dividends on all net earnings and that dividends had not been declared on all net earnings.[510] The court then turned to consider the breach of trust claim that were based on the "rights of minority stockholders apart from the objectives intended by the 1948 settlement agreement."[511]

The breach of trust claim was different in substance from the contract claim. The breach of trust claim was not based just on the failure to declare all dividends required but on the intentional and malicious conduct by the majority shareholder to reduce the amount of the net earnings available for dividends during the period of time that all earnings were to be paid out in dividends to the plaintiff's class of stock and ultimately to drive down the valuation of the corporation in anticipate of the defendants' exercise of its option to purchase. Plaintiff pleaded that "The St. Anthony's controlled board of directors charged certain salaries and directors' fees against The St. Anthony when they, by agreement, should have been charged to Pan American; that at one time when earnings amounted to $131,000, the board declared dividends of $50,000, conditioned upon [plaintiff's] written approval, failing which they told him they would declare only $40,000 dividends. He pleaded further that Pan American paid itself $95,863 out of operating cash for a debt which was not due until December 1979. He alleged that the defendants maliciously mismanaged the corporation for the wrongful purpose of

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502 *Id.*
503 *Id.*
504 *Id.*
505 *Id.*
506 *Id.*
507 *Id.*
508 *Id.* at 247.
509 *Id.* at 249.
510 *Id.* at 250.
511 *Id.*

reducing the minority's earnings and to suppress their dividends."[512]

The trial court had sustained special exceptions to the cause of action for dividends and damages, which the court of appeals stated raised the following questions: "Does a stockholder have any rights to dividends prior to the time they are declared? Does a stockholder have any rights incident to the stock after the exercise of an option to buy his stock? Does a former stockholder, independent of the corporation's rights to redress damage, individually have an action against the majority stockholder for breach of its trust toward the minority stockholder for mismanagement and the malicious refusal to declare dividends and suppress stock values?"[513] The court of appeals stated that the "answer to the first two questions is ordinarily in the negative but there are exceptions to the rule."[514] The court held: "Under certain circumstances, not only stockholders, but former stockholders, may assert an action for their own damages. The general rule does not prevent stockholders from suing to restrain, or recover damages for, wrongful acts which are not only wrongs against the corporation but also violations of duties arising from contracts or otherwise and owing directly to the injured stockholders."[515] The court stated, "Texas recognizes this exception to the general rule."[516]

Unlike in *Patton*, the direct/derivative issue in *Morrison* was central and squarely before the court: Was there a legal duty owed individually to the shareholder that would support a direct cause of action for equitable relief or damages arising from the malicious suppression of dividends? The court's answer was in the affirmative: "Generally, it is the corporation and not the stockholders which must redress wrongs which weaken corporate values. But in a proper case, where a majority stockholder has abused its discretion and has maliciously suppressed the payment of dividends, a stockholder may assert a cause of action for damages and may compel the declaration of dividends."[517] As authority for this proposition, the court of appeals cited *Patton v. Nicholas*.[518] The court further stated that "the duty of corporations, such as Pan

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[512] *Id.* at 252.

[513] *Id.* at 249.

[514] *Id.* at 249–50.

[515] *Id.* at 250.

[516] *Id.* at 251 (citing Massachusetts v. Davis, 168 S.W.2d 216, 222 (Tex. 1942)); Stinnett v. Paramount-Famous Lasky Corp., 37 S.W.2d 145, 150 (Tex. Comm'n App. 1931, holding approved, judgm't affirmed).

[517] *Id.* at 250.

[518] The court also cited numerous out of state cases upholding individual claims for dividends. *See* Warburton v. John Wanamaker Philadelphia, 196 A. 506, 510–11 (Pa. 1938) (suit by individual shareholder for breach of terms of preferred stock to pay dividends); Lydia E. Pinkham Med. Co. v. Gove, 20 N.E.2d 482, 486 (Mass. 1939) (suit by individual shareholder for violation of bylaw requiring payment of dividends); Crocker v. Waltham Watch Co., 53 N.E.2d 230, 233 (Mass. 1944) (suit by shareholder to compel dividends based on bylaw provision); New England Trust Co. v. Penobscot Chem. Fibre Co., 50 A.2d 188 (Me. 1946) (suit to compel dividends based on terms of preferred stock); W.Q. O'Neall Co. v. O'Neall, 25 N.E.2d 656, 660 (Ind. Ct. App. 1940) (suit to compel dividends to preferred shares based, not on express terms of preferred but "abuse [of] discretion by refusing so to do."); Burk v. Ottawa Gas & Elec. Co., 123 P. 857 (Kan. 1912) (suit for breach of bylaws requiring dividends); Patterson v. Durham Hosiery Mills, 200 S.E. 906 (N.C. 1939) (suit to enjoin amendment to charter that would remove right to dividends). Two of these cases were particularly relevant. In *Lydia E. Pinkham Med. Co. v. Gove*, the court rejects the argument that "the shareholder's right to have a dividend declared is wholly derivative, and that any suit that he may bring should be brought in behalf of the corporation as for a wrong to the corporation itself," and holds:

> We do not intend to intimate that a bill brought by a stockholder for the benefit of all stockholders would not lie. Such bills have succeeded for this purpose in other jurisdictions.

American in this case, which own controlling stock in a subsidiary corporation . . . is one of trust and strong presumptions come into force against the management which pays itself enormous management fees and refuses to pay dividends."[519]

> When a majority of the stock of one corporation is owned by another, which thereby acquires the right to control its management, the controlling corporation assumes a relation of trust towards the minority stockholders of the corporation controlled, and is under an obligation to manage its affairs for the benefit of all the stockholders and not for its own aggrandizement. This is merely an application of the principle that, while a majority of the stockholders may legally control the corporation's business, they assume the correlative duty of good faith, and cannot manipulate such business in their own interest to the injury of minority stockholders.[520]

The court concludes that the plaintiff had asserted valid causes of action "against The St. Anthony Hotel and Pan American Hotel Company, both under the contract by which the minority would receive all net earnings of The St. Anthony Hotel and on the breach of trust theory for damages."[521] The court of appeals reversed the dismissal and remanded for trial.[522]

*Morrison* was clearly an example of an individual action brought by the minority shareholder for his own benefit based on duties owed to himself. The plaintiff was not a shareholder at the time of the litigation. The first sentence of the opinion identifies the plaintiff as "R. E. Morrison, a former stockholder in The St. Anthony Hotel."[523] As such, the plaintiff could not have brought the action as a derivative claim,[524] a point made clearly in the dissent.[525] The fact that the plaintiff was no longer a shareholder also raises an important distinction between the remedies granted in *Morrison* and *Patton*. In *Patton*, the plaintiffs were still shareholders and the funds were still in the corporation; therefore, a mandatory injunction

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> Probably in most instances practical considerations will make this course necessary, as it will seldom happen that a corporation whose directors refuse to declare dividends will itself bring suit. But in a case like this one a right to sue in the corporation and a right to sue in the stockholders are not necessarily mutually exclusive.

20 N.E.2d at 490 (citations omitted). In *W.Q. O'Neall Co. v. O'Neall*, the court rejects argument that directors were necessary parties and holds that the court may render "judgment against the corporation for the dividends." 25 N.E.2d 656, 660 (Ind. Ct. App. 1940).

519 *Morrison*, 295 S.W.2d at 251 (citing Mayflower Hotel Stockholders Protective Comm. v. Mayflower Hotel Corp., 173 F.2d 416 (D.C. Cir. 1949)).

520 *Id.* (quoting Mayflower Hotel Stockholders Protective Comm., 173 F.2d at 422).

521 *Id.* at 252.

522 *Id.* at 252–53.

523 *Id.* at 247.

524 *See* Zauber v. Murray Sav. Ass'n, 591 S.W.2d 932, 937 (Tex. Civ. App.—Dallas 1979, writ ref'd) ("The reasoning behind allowing a shareholder to maintain a suit in the name of the corporation when those in control wrongfully refuse to maintain it is that a shareholder has a proprietary interest in the corporation. Therefore, when a shareholder sues, he is protecting his own interests as well as those of the corporation. If a shareholder voluntarily disposes of his shares after instituting a derivative action, he necessarily destroys the technical foundation of his right to maintain the action."). *See also* TEX. BUS. ORGS. CODE ANN. § 21.522 (West 2007).

525 *Morrison*, 295 S.W.2d at 253 (Murray, J., dissenting) ("Likewise, I am of the opinion that appellant's suit for damages for alleged breaches of fiduciary duties and mismanagement cannot be maintained by appellant since he is not a stockholder, but an exstockholder of the corporation.").

that the dividends be declared made the plaintiffs whole. In *Morrison*, the plaintiff was no longer a shareholder and could no longer receive dividends, and the claim in *Morrison* was not that the money was sitting there, but that the finances had been manipulated to reduce the funds available for dividends and that the money available for distribution had been taken out of the corporation. The plaintiff in *Morrison* was not in a position to benefit from an injunction to declare dividends and did not have standing to bring a derivative claim for misappropriation of assets. The only possible remedy was one for damages based on a breach of duty owed to the plaintiff individually.

As did *Patton*,[526] *Morrison* characterized the breach of duty as a "breach of trust."[527] The malicious conduct in *Morrison* resulting in the loss of dividends to the minority shareholder was also clearly an example of a claim for what *Cates v. Sparkman* termed "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" for which no other remedy existed.[528] In the intervening years, the *Morrison* opinion has been cited repeatedly as good authority.[529] In *Wingate v. Hajdik*,[530] the Texas Supreme Court held that the general rule that shareholders have no individual cause of action for harm done solely to the corporation "does not, of course, prohibit a stockholder from recovering damages for wrongs done to him individually where the wrongdoer violates a duty arising from contract or otherwise, and owing directly by him to the stockholder."[531] *Wingate* cited *Morrison* as a specific example of an individual claim by a shareholder "arising from contract or otherwise."[532] Both *Ritchie* and *Sneed* cited *Wingate* for that same proposition, although neither mention *Morrison*.[533]

### E. Question of Duty

The gaps left by the demise of the shareholder oppression doctrine are basically two-fold: (1) the absence of individual rights and duties that belong to every shareholder (what used to be called "general reasonable expectations") that protect individual shareholders from use of the corporation to specifically harm or eliminate their interests, and (2) the absence of individual equitable remedies, including a compulsory buy-out, that would protect "the legitimate interests of a minority shareholder" when the use of derivative claims to "protect[]

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526 Patton v. Nicholas, 279 S.W.2d 848, 854 (Tex. 1955) (breach of trust).

527 *Morrison*, 295 S.W.2d 246.

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

529 Schautteet v. Chester State Bank, 707 F. Supp. 885, 888 (E.D. Tex. 1988); Economy Gas, Inc. v. Burke, No. 14-93-01016-CV, 1996 WL 220903, at *9 n.2 (Tex. App.—Houston [14th Dist.] May 2, 1996, no pet.) (mem. op.) (not designated for publication); Horton v. Robinson, 776 S.W.2d 260, 263 (Tex. App.—El Paso 1989, no pet.); Bush v. Brunswick Corp., 783 S.W.2d 724, 727 (Tex. App.—Fort Worth 1989, pet. denied); Davis v. Sheerin, 754 S.W.2d 375, 384 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

530 Wingate v. Hajdik, 795 S.W.2d 717 (Tex. 1990).

531 *Id.* at 719.

532 *See id. See also* Schoellkopf v. Pledger, 739 S.W.2d 914, 919 n.9 (Tex. App.—Dallas 1987) (citing *Morrison v. St. Anthony Hotel* for the proposition that "a minority stockholder may sue majority stockholder for malicious suppression of dividends and mismanagement to suppress the value of the stock, as breach of duty of trust between majority and minority stockholders"), *rev'd on other grounds*, 762 S.W.2d 145 (Tex. 1988).

533 *See* Sneed v. Webre, 465 S.W.3d 169,188 (Tex. 2015); Ritchie v. Rupe, 443 S.W.3d 856, 888 n.55 (Tex. 2014).

the well-being of the corporation" would not do so.[534] This section has reviewed several landmark cases that are not based on the shareholder oppression doctrine for the purpose of demonstrating that Texas common law does recognize that individual minority shareholders do have causes of action based on the violation of their individual rights and duties owed to them and that Texas courts have granted equitable relief to individual shareholders. *Stinnett v. Paramount-Famous Lasky Corp. of N.Y.* and the case it chiefly relies on, *Ritchie v. McMullen*, held that individual shareholders have a claim for conduct harmful to themselves, even if that same conduct harms the corporation, but only where the law recognizes an independent duty owed to the shareholder individually. *Cates v. Sparkman* describes the kind of situations in which such a cause of action might arise. *Cates* describes an individual cause of action that an individual shareholder would bring against the corporation (not the officers and directors) for corporate actions that constitute "injurious practices, abuse of power, and oppression." [535] *Cates* does not describe what such conduct would be, other than to make clear that ordinary, operational decisions, such as shutting down the company when the money runs out, are not the kinds of conduct that constitutes "injurious practices, abuse of power, and oppression." *Patton v. Nicholas* and *Morrison v. St. Anthony Hotel* are two examples of individual claims asserted by minority shareholders, as described in *Cates*, for violation of duties owed directly to themselves, as stated in *Stinnett*. The elements of a claim for breach of trust, for which both courts ruled that an equitable remedy would be available, were not clearly defined in either case.

None of the cases re-examined in this section, however, defines the cause of action with any precision. *Cates* basically lays out the three elements of an individual shareholder cause of action against the corporation: (1) An intentional breach of duty by the corporation ("injurious practices, abuse of power, and oppression on the part of the company or its controlling agency"); (2) Material violation of rights of the plaintiff shareholder ("clearly subversive of the rights of the minority, or of a shareholder"); and (3) No adequate remedy at law ("which, without such [an equitable remedy], would leave the latter remediless").[536] The elements described by *Cates* are clearly discernible in both *Patton* and *Morrison*: (1) Intentional breach of duty by the corporation (suppressing dividends for the malicious purpose of harming the minority shareholder); (2) Material violation of rights of the plaintiff shareholder (right to share in profits of the corporation); and (3) No adequate remedy at law. However, defining the breach of duty using the terms "injurious practices, abuse of power, and oppression" is less than satisfactory. As the Texas Supreme Court commented in *Ritchie*, the term "oppression" is extremely vague and "falls short of providing any clear standards" necessary to "deter the undesirable conduct without deterring desirable conduct or unduly restricting freedoms."[537] Basing a cause of action on terms "so vague and subject to so many different meanings in different circumstances . . . is simply bad jurisprudence."[538] In order to better define the elements of this breach of trust cause of action, it is necessary to determine precisely what substantive rights the law recognizes as belonging to every shareholder by virtue of being a shareholder and what duties the corporation owes to each shareholder so that we may

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534 *See Ritchie*, 443 S.W.3d at 888.

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

536 *Id.*

537 *Ritchie*, 443 S.W.3d at 889.

538 *Id.* at 890.

demonstrate that the "theory of liability [is] based on a standard that is far more concrete than the meaning of 'oppressive.'"[539]

## V. RECOGNIZING INDIVIDUAL RIGHTS OF MINORITY SHAREHOLDERS

### A. Stock Ownership as Personal Property

In Texas, property rights are "sacred and fundamental"[540] "a foundational liberty, not a contingent privilege,"[541] "natural, inherent, inalienable, not derived from the legislature and as preexisting even constitutions."[542]

> The right to acquire and own property, and to deal with it and use it as the owner chooses, so long as the use harms nobody, is a natural right. It does not owe its origin to constitutions. It existed before them. It is a part of the citizen's natural liberty—an expression of his freedom, guaranteed as inviolate by every American Bill of Rights.
>
> The ancient and established maxims of Anglo-Saxon law which protect these fundamental rights in the use, enjoyment and disposal of private property, are but the outgrowth of the long and arduous experience of mankind. They embody a painful, tragic history—the record of the struggle against tyranny, the overseership of prefects and the overlordship of kings and nobles, when nothing so well bespoke the serfdom of the subject as his incapability to own property. They proclaim the freedom of men from those odious despotisms, their liberty to earn and possess their own, to deal with it, to use it and dispose of it, not at the behest of a master, but in the manner that befits free men.[543]

The Texas Supreme Court has stated that "freedom itself [] demand[s] strong protections for individual property rights."[544] Protection of those rights is "one of the most important purposes of government."[545]

Stock is personal property, and the stockholder is a property owner.[546] Texas law has long

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[539] *Id.*

[540] State v. Texas City, 295 S.W.2d 697, 704 (Tex. Civ. App.—Galveston 1956), *aff'd*, 303 S.W.2d 780 (Tex. 1957); Ford v. Grand United Order of Odd Fellows, 50 S.W.2d 856, 859 (Tex. Civ. App.—Beaumont 1932, writ dism'd w.o.j.) ("right to own and have exclusive dominion over private property is a sacred one").

[541] Tex. Rice Land Partners, Ltd. v. Denbury Green Pipeline-Texas, L.L.C., 363 S.W.3d 192, 204 n.34 (Tex. 2012).

[542] Eggemeyer v. Eggemeyer, 554 S.W.2d 137, 140 (Tex. 1977).

[543] Spann v. City of Dallas, 235 S.W. 513, 515 (Tex. 1921).

[544] *Tex. Rice Land Partners, Ltd.*, 363 S.W.3d at 204.

[545] *Eggemeyer*, 554 S.W.2d at 140.

[546] TEX. BUS. ORGS. CODE ANN. § 21.801 (West 2006) ("Except as otherwise provided by this code, the shares and other securities of a corporation are personal property."); Engel v. Teleprompter Corp., 703 F.2d 127, 131 (5th Cir. 1983) ("Under Texas law, shares of corporate stock are personal property."); Capital Parks, Inc. v. Se. Advert. & Sales Sys., Inc., 864 F. Supp. 14, 16 (W.D. Tex. 1993) ("The shares of corporate stock, on the other hand, are the personal

recognized "the property right which a share in such a company creates."[547]

> Shares of stock in a corporation are a species of personal property, belonging to the holder thereof, entirely separate and distinct from the property of the corporation itself. They are the subject of barter and sale the same as other personal property. Under our laws they are subject to taxation, may be impounded by garnishment proceedings, and may be sold under execution as other personal property. They are the intangible interests of the individual shareholders in the corporate business, while the tangible property belongs to the corporation.[548]

What does it mean to own a personal property interest in "stock"? First, it is important to note that "owning stock" does not mean possessing a stock certificate. Texas law has long held that the certificate is not the "stock."[549] The certificate is merely evidence of the ownership of the stock.[550] A stockholder owns the stock whether or not he possesses the certificate and regardless of whether a certificate was ever even issued.[551]

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property of the shareholders."), *aff'd*, 30 F.3d 627 (5th Cir. 1994); Barnhill v. Automated Shrimp Corp., 222 S.W.3d 756, 764 (Tex. App.—Waco 2007, no pet.) ("By virtue of owning shares of stock in a Texas corporation, Barnhill maintains personal property in Texas."); Brosseau v. Ranzau, 81 S.W.3d 381, 387 (Tex. App.—Beaumont 2002, pet. denied) ("In Texas, stock is considered personal property, even when the underlying corporation itself owns real property."); Evans v. Prufrock Rests., Inc., 757 S.W.2d 804, 805–06 (Tex. App.—Dallas 1988, writ denied) ("[T]he transaction was the sale of a personalty rather than realty. . . . It is a well established fact that the sale of stock is personalty not real estate."); Griffith v. Jones, 518 S.W.2d 435, 437 (Tex. Civ. App.—Tyler 1974, writ ref'd n.r.e.) ("Shares of corporate stock are personal property in the nature of choses in action."); Benson v. Greenville Nat'l Exch. Bank, 253 S.W.2d 918, 928 (Tex. Civ. App.—Texarkana 1952, writ ref'd n.r.e.) ("Without any attempt at historical review, we think it is now well settled that shares of corporate stock are personal property in the nature of choses in action"). *See also* Dewing v. Perdicaries, 96 U.S. 193, 196 (1877) ("The shares are a distinct and separate property."); Cummings v. People, 71 N.E. 1031, 1034 (Ill. 1904); Auto. Mortg. Co. v. Ayub, 266 S.W. 134, 135 (Tex. Comm'n App. 1924, judgm't adopted) ("While not negotiable, shares are freely assignable, and in this respect resemble negotiable choses in action and tangible property rather than other nonnegotiable choses in action."); Bergin v. Bergin, 312 S.W.2d 409, 412 (Tex. Civ. App.—Texarkana), *rev'd on other grounds*, 315 S.W.2d 943 (Tex. 1958) ("Corporate stock, which is personalty, is involved."); Parker v. Mona-Marie Trust, 278 S.W. 321, 323 (Tex. Civ. App.—Fort Worth 1925, no writ) ("Shareholders are not tenants in common or co-owners of the property of the corporation in any sense; but the title thereto rests in the legal entity called the corporation.").

[547] Yeaman v. Galveston City Co., 167 S.W. 710, 719 (Tex. 1914).

[548] *Auto. Mortg. Co.*, 266 S.W. at 135.

[549] *Yeaman*, 167 S.W. at 720 ("In a corporation the certificate of stock is not the stock itself").

[550] *Id.* (stating that the share certificate "is but a muniment of title, an evidence of the ownership of the stock."); Greenspun v. Greenspun, 194 S.W.2d 134, 137 (Tex. Civ. App.—Fort Worth), *aff'd*, 198 S.W.2d 82 (Tex. 1946) ("In this latter connection it is to be remembered that the certificates of stock are not in themselves property, but are only evidence of the interest of the stockholder in the corporation."); A. B. Frank Co. v. Latham, 190 S.W.2d 739, 741 (Tex. Civ. App.—Austin 1945), *aff'd*, 193 S.W.2d 671 (Tex. 1946) ("Nor does mere cancellation of the stock certificates effect a reduction of the capital. They are but evidences in the hands of the holder of his aliquot part of the legal capital of the corporation."). *See also Dewing*, 96 U.S. at 196 ("The stock of such corporations may be held by a valid title without a certificate. The certificate is only one of the indicia of title. The right to the stock is in the nature of a non-negotiable chose in action.").

[551] *Yeaman*, 167 S.W. at 720 (Possession of a stock certificate "is not necessary to a subscriber's complete ownership of the stock."); *Greenspun*, 194 S.W.2d at 137 ("It is possible under some circumstances for one to own stock in a corporation though no certificate has been issued to him or endorsed or delivered to him, and likewise it is possible under some circumstances for title to the stock to pass without delivery of the certificate of stock or without

Rather, "stock" constitutes an undivided partial ownership interest in the corporation. Courts analogize the corporation to a trust fund made up of the assets, opportunities, and business operations of the corporate enterprise.[552] Each share of stock is an undivided, proportional ownership interest in the trust fund.[553] However, ownership of the trust fund itself and ownership of the partial interest in that fund are completely different things.[554] The corporation owns the trust fund[555] but does so as trustee[556] for the benefit of the shareholders.[557]

### B. The Stockholder's Bundle of Property Rights

In *Moroney v. Moroney*,[558] the court wrote:

> The corporation is a legal entity, and the title to its assets is vested in the corporation. The stockholder does own, however, his shares, stock, or interest whatsoever in the corporation, and this carries with it certain legal rights, but they are not the rights of a legal owner of the corporation assets in whole or in part. This distinction holds good even though all the stock may be held by a single individual. It does not follow from this, however, that the rights of a stockholder in a corporation are not of judicial

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written assignment of it."); Estate of Bridges v. Mosebrook, 662 S.W.2d 116, 121 (Tex. App.—Fort Worth 1983, writ denied); Estate of Crawford, 795 S.W.2d 835, 838 (Tex. App.—Amarillo 1990, no writ) ("Complete ownership of certificated stock may exist without the issuance of a certificate or its delivery.").

[552] *Dewing*, 96 U.S. at 196 ("The capital stock and all the other property and effects of a corporation are a trust fund.").

[553] *Id.* (shares represent "aliquot parts of the trust fund"); Farrington v. Tennessee, 95 U.S. 679, 687 (1877) ("Each share represents an aliquot part of the capital stock."). *See also Auto. Mortg. Co*., 266 S.W. at 135 ("It is generally agreed that shares in an incorporated company are the aliquot parts of the capital stock, and merely give to the owner a right to his share of the profits of the corporation, while it is a going concern, and to a share of the proceeds of its assets, when sold for distribution in case of its dissolution and winding up.") (quoting Presnall v. Stockyards Nat'l Bank, 151 S.W. 873, 876 (Tex. Civ. App.—Texarkana 1912), *aff'd*, 194 S. W. 384 (Tex. 1917)).

[554] *Auto. Mortg. Co.*, 266 S.W. at 135 ("Shares of stock in a corporation are a species of personal property, belonging to the holder thereof, entirely separate and distinct from the property of the corporation itself."); *Farrington*, 95 U.S. at 686 ("The capital stock [i.e., the corpus of the trust fund] and the shares of the capital stock are distinct things.").

[555] Tenneco Inc. v. Enter. Prods. Co., 925 S.W.2d 640, 645 (Tex. 1996); *see also* McAlister v. Eclipse Oil Co., 98 S.W.2d 171, 176 (Tex. 1936) ("Under our authorities the corporation is a legal entity, distinct from its stockholders. In this regard, strictly speaking, the ownership of the corporate assets is vested in the corporation itself and not in its stockholders."); Hicks v. State, 419 S.W.3d 555, 558 (Tex. App.—Amarillo 2013, no pet.) ("It has long been the law that a stockholder owns an interest in the company but not the assets of the company. Rather, the assets, including the cash residing in corporate bank accounts, are owned by the corporation, and the latter is a separate legal entity from its shareholders.").

[556] *Dewing*, 96 U.S. at 196 ("The corporation owns and holds [the trust fund] as a trustee."); *Farrington*, 95 U.S. at 686 ("It is a trust fund, held by the corporation as a trustee.").

[557] *Farrington*, 95 U.S. at 687 ("Every [stock]holder is a cestui que trust to the extent of his ownership."); *McAlister*, 98 S.W.2d at 176 ("Also, strictly speaking, the ownership of the stock does not carry with it the equitable title to the corporate property. This simply means, however, that the stockholders have no right to require the corporation to convey to them the legal title to the corporate property. In a larger or real sense the stockholders of a corporation are the beneficial owners of its corporate properties.").

[558] 286 S.W. 167 (Tex. Comm'n App. 1926, judgm't affirmed).

cognizance.[559]

So what does the shareholder actually own? The shares of stock that a shareholder owns consist of a set of intangible rights and interests with respect to the corporate enterprise.[560] However, all property ownership ultimately constitutes an intangible "bundle of rights."[561] The concept of property does not refer to a thing but rather to the rights and legal relationship between a person and a thing.[562] The common law and statutes define these rights.[563] The Texas Supreme Court has listed among the "core rights in the bundle of property rights":

> (1) the right to exclusive possession; (2) the right to personal use and enjoyment; (3) the right to manage use by others; (4) the right to the income from use by others; (5) the right to the capital value, including alienation, consumption, waste, or destruction; (6) the right to security (that is, immunity from expropriation); (7) the power of transmissibility by gift, devise, or descent.[564]

In the context of stock ownership, Texas courts recognize that "[t]here are certain rights, powers, and privileges that accrue to a stockholder in a corporation."[565] This "array of rights" possessed the individual shareholders "spring from many sources: (1) the corporation's organic documents, (2) agreements between shareholders or between the corporation and shareholders, (3) statutory corporation law, and (4) decisional law governing the operation of corporations."[566] The shareholder's bundle of rights and interests that have been developed in the common law derive "from the nature of the organization, and the relation of the stockholders to the corporation and its property."[567]

For purposes of protecting minority shareholders from oppressive and predatory conduct in closely-held corporations, we will focus on five basic components of the "bundle" or "array" of rights and interests that constitute stock ownership and are subject to legal protections. The Texas Constitution establishes a legal mandate that Texas law "provide fully

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559 *Id.* at 169.

560 Turner v. Cattleman's Trust Co., 215 S.W. 831, 832 (Tex. Comm'n App. 1919, judgm't adopted) ("The tangible property belongs to the corporation. The shares of stock are the intangible interests in the corporate business owned by the individual shareholders."); Presnall v. Stockyards Nat'l Bank, 151 S.W. 873, 876 (Tex. Civ. App.—Texarkana 1912), *aff'd*, 194 S.W. 384 (Tex. 1917) ("by a 'share of stock' and 'share' in a corporation, as used in the statute, is meant an intangible interest or right, in legal contemplation, of the owner in the corporation property or fund").

561 *E.g.*, Evanston Ins. Co. v. Legacy of Life, Inc., 370 S.W.3d 377, 382 (Tex. 2012) ("We have referred to property as a 'bundle of rights.'"); Canyon Reg'l Water Auth. v. Guadalupe-Blanco River Auth., 258 S.W.3d 613, 618 (Tex. 2008) ("Where an owner possesses a full 'bundle' of property rights, the destruction of a 'strand' of the bundle is not a taking.").

562 *Evanston Ins. Co*., 370 S.W.3d at 382–83.

563 *Id.* at 383.

564 *Id.*

565 *Turner*, 215 S.W. at 833.

566 Schautteet v. Chester State Bank, 707 F. Supp. 885, 888 (E.D. Tex. 1988).

567 Moroney v. Moroney, 286 S.W. 167, 169 (Tex. Comm'n App. 1926, judgm't affirmed). However, it should be noted that because corporations are set up differently, these rights and interests "may well vary from one corporation to the next." *Schautteet*, 707 F. Supp. at 888.

for the adequate protection . . . of the individual stockholders."[568] Texas courts have held that, in every profitable corporate venture, the rights of the stockholder are of great importance, and at all times will be properly protected, whether in a court of law or equity, according to the exigencies of the situation.[569]

### *I. Recognition of Ownership*

Perhaps the most obvious and central right of ownership is the assurance that the law will protect the existence and continuation of that ownership—that the owner has "the right to exclusive possession" and "the right to security."[570] The stockholder is an owner. The stock is his property. It cannot be taken away without his consent.[571]

In the context of a shareholder's ownership, this right means at a minimum that the corporation may not act to impair the shareholder's ownership interest.[572] The stockholder has the right to have his ownership recorded on the books of the corporation[573] and to have issued and delivered a stock certificate as written evidence of that ownership.[574]

### *II. Voice.*

Another fundamental right of property ownership is the right to manage the use of that property by others.[575] The nature of the corporate organization involves control by the corporate entity over what the stock represents. Shareholders elect directors who "direct the management of the business and affairs of the corporation" without direct input by the shareholders.[576] Yet the owner of the stock is entitled to a voice in owner-level decisions: who is to manage the property, what limitations or requirements are to be imposed on the managers, and whether to sell or make fundamental changes in the nature of the enterprise. Shareholders decide certain fundamental transactions[577] and whether to remove directors[578] Some owner-

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[568] TEX. CONST. art. XII, § 2.

[569] *Moroney*, 286 S.W. at 169.

[570] *Evanston Ins. Co.*, 370 S.W.3d at 383. *See also* Dos Republicas Coal P'ship v. Saucedo, 477 S.W.3d 828, 836 (Tex. App.—Corpus Christi-Edinburg 2015, no pet.) ("Under Texas common law, property ownership comes with a 'bundle of rights' which includes, among other things, the rights of possession and use."); Apr. Sound Mgmt. Corp. v. Concerned Prop. Owners for Apr. Sound, Inc., 153 S.W.3d 519, 525 (Tex. App.—Amarillo 2004, no pet.) ("The right to own and have exclusive dominion over private property is a sacred one, and it is a universal principle of law that the right to own property carries with it the right to control and dispose of it in such manner as not to contravene law or public policy.").

[571] Yeaman v. Galveston City Co., 167 S.W. 710, 723 (Tex. 1914) ("We are unwilling to affirm that, in the absence of some statutory or charter power, or express consent to that effect, a corporation has any authority to forfeit a stockholder's shares upon such a ground.").

[572] *Id.*

[573] TEX. BUS. ORGS. CODE ANN. § 3.151(a)(3) (West 2006).

[574] *Id.* § 3.204.

[575] *Evanston Ins. Co.*, 370 S.W.3d at 383.

[576] BUS. ORGS. § 21.401. *See, e.g.,* Solum Eng'g, Inc. v. Preis & Roy, P.L.C., No. 14-10-01054-CV, 2011 WL 4490049, at *3 (Tex. App.—Houston [14th Dist.] Sept. 29, 2011, pet. denied) ("[A] shareholder cannot terminate a corporation's contractual obligations . . . .").

[577] BUS. ORGS. § 21.058 (amending bylaws); *id.* §§ 21.055(b), 21.364(b) (amending certificates); *id.* § 1.002(32) (mergers); *id.* § 21.452(e) (sales of all or substantially all a corporation's assets other than in the

level decisions require unanimity,[579] some a majority,[580] some a super-majority,[581] and the stockholder is entitled to his proportional share of the vote on each such decision. Among the "rights, powers, and privileges that accrue to a stockholder in a corporation," are "the right to attend stockholders' meetings and vote on matters under consideration by shareholders; the right to hold official position of trust in the corporation."[582] The right to vote, in particular, has long been recognized as one of the "incidents" of stock ownership.[583] But the broader principle, critical for the minority shareholder in a closely-held corporation who will likely always be out-voted, is that those in control of the corporation remain accountable to and ultimately subject to the will of the owners (collectively)—all the owners—and minority shareholders have a voice and a right to participate in that process. The shareholder's right to voice is more than the mere right to vote on a limited number of matters; it is the right to hold the corporation's management accountable to all of the shareholders and to confront management on matters about which the shareholder disagrees.[584] Therefore, each stockholder has a fundamental right to meet periodically with the other shareholders, to require that corporate management report to and remain accountable to all shareholders, to have the opportunity to ask questions and express opinions, and to vote on the directors and other matters in a proceeding where the vote of every share of the same class will be counted the same.[585]

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ordinary course of business); *id.* § 21.457(a); *id.* §§ 1.002(32), 21.455(f), 21.457(a) (voluntary winding ups); *id.* §§ 21.364(b), 21.503(b).

[578] *See id.* §§ 21.405(a), 21.409(a). *See, e.g.,* Adams v. Farmers Gin Co., 114 S.W.2d 583, 587 (Tex. Civ. App.—Eastland 1938, no writ) (right of management of business of corporation is vested in directors rather than shareholders; remedy of shareholders if they disapprove of management decisions is to elect new directors in prescribed manner at regular time); *see also* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 959 (Del. 1985) ("If the stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out.").

[579] BUS. ORGS. § 21.502 (winding up or decision to revoke winding up); *id.* § 21.715 (shareholders' agreement).

[580] *Id.* § 21.409 (removal of director(s)); *id.* § 21.502(2) (winding up if business has not issued shares); *see id.* § 21.454 (approval of exchange of shares); *id.* § 21.455(a) (approval of sale of all or substantially all of assets).

[581] *Id.* § 21.364 (amend certificate of formation, reinstatement, increase or decrease total number of authorized shares, change par value of shares, change rights of shares, create a new class of shares, change already declared dividend); *id.* § 21.457 (approval of fundamental business transaction).

[582] Turner v. Cattleman's Trust Co., 215 S.W. 831, 833 (Tex. Comm'n App. 1919, judgm't adopted).

[583] Farrington v. Tennessee, 95 U.S. 679, 687 (1877). ("The corporation, though holding and owning the capital stock, cannot vote upon it. It is the right and duty of the shareholders to vote. They in this way give continuity to the life of the corporation, and may thus control and direct its management and operations."); Morrison v. St. Anthony Hotel, 274 S.W.2d 556, 567 (Tex. Civ. App.—Austin 1955, writ ref'd n.r.e.) ("incidents of stock ownership" include "the rights, pro tanto, to share in its management"). *See also* Baker v. Raymond Int'l, Inc., 656 F.2d 173, 180 (5th Cir. 1981) ("Ownership of a controlling interest in a corporation entitles the controlling stockholder to exercise the normal incidents of stock ownership, such as the right to choose directors and set general policies, without forfeiting the protection of limited liability.").

[584] Grayburg Oil Co. v. Jarratt, 16 S.W.2d 319, 320 (Tex. Civ. App.—El Paso 1929, no writ) ("We can see no good reason why a stockholder in a corporation who is dissatisfied with the internal management of the corporate affairs should not have the right to call to the attention of his fellow stockholders conditions in the corporate management with which he is dissatisfied and in good faith regards as prejudicial to the best interest of the corporation and its stockholders. In our opinion, stockholders have such right.").

[585] *See* BUS. ORGS. §§ 21.351–.363.

## *III. Information.*

A necessary corollary to the fundamental right to manage the use of one's property by others is the right to information, so that the shareholder may "ascertain whether the affairs of the corporation are properly conducted and that he may vote intelligently on questions of corporate policy and management."[586] "A minority shareholder has very few rights. By definition, those shareholders who, along with their allies, are in the majority, have sufficient votes to nullify the minority's right of franchise. In such instance, about the only thing left to a dissatisfied minority stockholder is his right to inspect, coupled with his right to denounce any matters disclosed by his inspection."[587] The right to information has been held to be "a privilege . . . incident to [the] ownership of stock,"[588] and a "valuable right."[589] The owner is entitled to know what is going on in his own company, how his investment is doing, what it is worth, how his money is being spent, how his property is being managed.

Corporations are required by statute to keep records and accounts and to permit shareholders to inspect the records.[590] The statutory right of inspection in Texas is limited to current shareholders who have held their shares for at least six months or who hold at least five percent of all the outstanding shares of the corporation.[591] However, all shareholders have a common law right of inspection if the inspection is made in good faith for a proper purpose.[592] "There can be no question that the decisive weight of American authority recognizes the common-law right of the shareholder, for proper purposes and under reasonable regulations as to place and time, to inspect the books of the corporation of which he is a member."[593] Texas courts have held that the passage of a legislative right of inspection does not negate the preexisting common-law right.[594] Similarly, the inspection statute itself makes clear that it does not preempt common-law rights.[595]

## *IV. Right of Alienation*

The rights of property ownership include "the right to the capital value, including alienation . . . [and] the power of transmissibility by gift, devise, or descent."[596]

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586 Johnson Ranch Royalty Co. v. Hickey, 31 S.W.2d 150, 153 (Tex. Civ. App.—Amarillo 1930, writ ref'd).

587 Perry v. Perry Bros., Inc., 753 S.W.2d 773, 777 (Tex. App.—Dallas 1988, no writ) (Howell, J., dissenting).

588 *Johnson Ranch Royalty Co.*, 31 S.W.2d at 153 (shareholder's right to examine the books and records of the corporation "is a privilege . . . incident to his ownership of stock.").

589 Chavco Inv. Co., Inc. v. Pybus, 613 S.W.2d 806, 809 (Tex. Civ. App.—Houston [14th Dist.] 1981, writ ref'd n.r.e.) ("The right of a stockholder as conferred by statute to examine the corporate records, although not absolute, is a valuable right.").

590 *See* BUS. ORGS. §§ 3.151–.153, 21.173, 21.218–.222.

591 *Id.* § 21.218(b).

592 Williams v. Freeport Sulphur Co., 40 S.W.2d 817, 825 (Tex. Civ. App.—Galveston 1930, no writ) (holding that the right of inspection is provided "both by the common law and the statutes of this state"); *see also* Palacios v. Corbett, 172 S.W. 777, 782 (Tex. Civ. App.—San Antonio 1915, writ ref'd) (finding a common law right to inspect county records).

593 Guthrie v. Harkness, 199 U.S. 148, 153 (1905).

594 Tex. Infra-Red Radiant Co. v. Erwin, 397 S.W.2d 491, 493 (Tex. Civ. App.—Eastland 1965, writ ref'd n.r.e.).

595 BUS. ORGS. § 21.218(c).

596 Evanston Ins. Co. v. Legacy of Life, Inc., 370 S.W.3d 377, 383 (Tex. 2012).

"Transferability is the primary value-imparting characteristic of most property interests,"[597] including stock ownership.[598] "Alienability is a legal incident of property, and restraints against it are generally contrary to public policy."[599] While restrictions on the transferability of stock are permitted, they must be reasonable, consented to by the stockholder, clearly disclosed, and not violative of public policy.[600]

### *V. Proportional Share in the Profits.*

Another fundamental property right is the "right to the income from use by others."[601] As the Texas Supreme Court has stated, "a right to [property] essentially implies a right to profits accruing from it, since, without the latter, the former can be of no value."[602] The principal reason for stock ownership is the expectation of economic return, if the venture is successful. Texas cases have held that the right to share "pro tanto" in the corporation's "profits and, upon dissolution, its assets" are among the "incidents of stock ownership."[603] Among the "rights, powers, and privileges that accrue to a stockholder in a corporation" is "the right to receive dividends from the profits and gains made by the common fund."[604] So important is the right of shareholders to participate in corporate profits, "that courts of equity will, in a proper case, compel a payment of dividends."[605] Because the shareholder beneficially owns a definite portion of the corporate enterprise, his property right is not only to receive a share in any economic return but to receive the full proportional share of what is his own.[606]

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[597] Cooper v. United States, 322 F. Supp. 2d 733, 737 (E.D. Tex. 2004).

[598] *See* Tenneco, Inc. v. Enter. Prod. Co., 925 S.W.2d 640, 646 (Tex. 1996) ("Sound corporate jurisprudence requires that courts narrowly construe rights of first refusal and other provisions that effectively restrict the free transfer of stock."); Sandor Petroleum Corp. v. Williams, 321 S.W.2d 614, 617 (Tex. Civ. App.—Eastland 1959, writ ref'd n.r.e.) ("Generally speaking, corporate shares of stock are property which may be freely sold and delivered.").

[599] Hicks v. Castille, 313 S.W.3d 874, 881 (Tex. App.—Amarillo 2010, pet. denied); *see* TEX. CONST. art. I, § 26 interp. commentary (West 2007) ("The framers of the Texas Constitutions, beginning with that of the Republic, have believed in an unrestrained power to convey or transfer property, and thus have written into the Bill of Rights this provision against perpetuities, primogeniture and the entailment of estates.").

[600] Dixie Pipe Sales, Inc. v. Perry, 834 S.W.2d 491, 493 (Tex. App.—Houston [14th Dist.] 1992, writ denied); *see also* BUS. ORGS. § 21.209 ("Except as otherwise provided by this code, the shares and other securities of a corporation are transferable in accordance with Chapter 8, Business & Commerce Code."); *id.* §§ 21.210–.213 (stating manner of creating restrictions and listing examples of valid restrictions on transfer of shares); TEX. BUS. & COM. CODE ANN. § 8.204 & cmt. 1 (West 1995) (validity of restriction determined by other law, but any restriction on transfer must be noted conspicuously on certificate if certificated security to be enforceable).

[601] *Evanston Ins. Co.*, 370 S.W.3d at 383.

[602] Sheffield v. Hogg, 77 S.W.2d 1021, 1028 (Tex. 1934); *see also* Exxon Corp. v. Breezevale Ltd., 82 S.W.3d 429, 436–37 (Tex. App.—Dallas 2002, pet. denied) ("[T]hus a devise of the profits of land, or even a grant of them, will pass a right to the land itself. Thus, a conveyance of an interest in the minerals that are produced from land, such as a working interest or a royalty interest, passes a right to the land itself."); U.S. Pipeline Corp. v. Kinder, 609 S.W.2d 837, 839 (Tex. Civ. App.—Fort Worth 1980, writ ref'd n.r.e.).

[603] Morrison v. St. Anthony Hotel, 274 S.W.2d 556, 567 (Tex. Civ. App.—Austin 1955, writ ref'd n.r.e.).

[604] Turner v. Cattleman's Trust Co., 215 S.W. 831, 833 (Tex. Comm'n App. 1919, judgm't adopted).

[605] Moroney v. Moroney, 286 S.W. 167, 169 (Tex. Comm'n App. 1926, judgm't affirmed); *see also* Farrington v. Tennessee, 95 U.S. 679, 687 (1877) (listing among the fundamental aspects of share ownership the entitlement "to share in the dividends and profits.").

[606] *See* Auto. Mortg. Co. v. Ayub, 266 S.W. 134, 135 (Tex. Comm'n App. 1924, judgm't adopted) ("It is generally agreed that shares in an incorporated company are the aliquot parts of the capital stock, and merely give to the owner a right to his share of the profits of the corporation, while it is a going concern, and to a share of the

# VI. RECOGNIZING DUTIES THAT CORPORATIONS OWE TO EVERY SHAREHOLDER

## A. Beneficial Nature of Stock Ownership

### *1. Corporation Is a Trustee for the Stockholders*

Unlike other forms of property ownership, stock ownership involves both a direct aspect—direct ownership of the shareholder's undivided partial interest in the corporation, usually represented by the stock certificate—and an indirect aspect—what the "stock" represents, an undivided partial interest in the assets and business operations owned and controlled by the corporation. The Texas Supreme Court in *Sneed v. Webre* recently acknowledged that a shareholder's ownership of "stock" is actually a beneficial or equitable ownership interest in the assets and business enterprise of the corporation.[607] The Court noted that Texas law "recognized that 'the stockholders are the beneficial owners of the assets of the corporation' well over a century ago."[608] The "beneficial title to the assets of the corporation is

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proceeds of its assets, when sold for distribution in case of its dissolution and winding up.") (quoting Presnall v. Stockyards Nat'l Bank, 151 S. W. 873 (Tex. Civ. App.—Texarkana 1912), *aff'd*, 194 S.W. 384 (Tex. 1917); Olsen v. Homestead Land & Imp. Co., 28 S.W. 944 (Tex. 1894) ("The right which a shareholder in a corporation has by reason of his ownership of shares is a right to participate, according to the amount of his stock, in the surplus profits of the corporation on a division, and ultimately on its dissolution in the assets remaining after the payment of its debts."); Byerly v. Camey, 161 S.W.2d 1105, 1110 (Tex. Civ. App.—Fort Worth 1942, writ ref'd w.o.m.) ("The stockholder has a right to his share of the profits while the corporation is a going concern, and to a share of the proceeds of its assets, when sold for distribution in case of its dissolution and winding up."). *See* I-10 Colony, Inc. v. Chao Kuan Lee, 393 S.W.3d 467, 478 (Tex. App.—Houston [14th Dist.] 2012, pet. denied) ("The general rule for cotenants in Texas is that they are required to share any income or rents generated from the jointly-owned property according to their respective interests . . . ."). The analogy breaks down to some extent because shareholders do not hold direct title to the corporate assets and thus are not really tenants in common of those assets, at least not until dissolution. Eddings v. Black, 602 S.W.2d 353, 358 (Tex. Civ. App.—El Paso 1980, writ ref'd n.r.e.) ("[W]here the tenant in possession rents the property to a third person, he must account to his cotenant. Rents and profits received by one cotenant are held by him in trust for his cotenants."); *Auto. Mortgage Co.*, 266 S.W. at 135 (quoting U.S. Radiator Corp. v. State, 101 N.E. 783, 786 (N.Y. 1913)) ("The whole title to it is in the corporation, and the shareholders are neither tenants in common nor in any legal sense the owners of it."); Montgomery v. Heath, 283 S.W. 324, 327 (Tex. Civ. App.—Amarillo 1926) (the shareholders of the defunct corporation become "owners as tenants in common of its property"), *aff'd in part, rev'd in part on other grounds*, 291 S.W. 855 (Tex. Comm'n App. 1927, holding approved). Shareholders do not have a right to an accounting from each other for disproportionate benefits; however, they do have the right to their proportional share of the earnings from the corporation. *See also* Burton v. Exxon Corp., 583 F. Supp. 405, 418 (S.D. N.Y. 1984) ("[S]tockholders are owners of the corporation and expect to share in its profits."); Michaud v. Morris, 603 So. 2d 886, 888 (Ala. 1992) ("Certain basic expectations of investors are enforceable in the courts, and among those is a right to share proportionally in corporate gains."); Burt v. Burt Boiler Works, Inc., 360 So. 2d 327, 332 (Ala. 1978) ("Should they, acting through the board and corporate officers, which they control, deprive the minority stockholders of their just share of the corporate gains, such would, of course, be actionable."); Baur v. Baur Farms, Inc., 832 N.W.2d 663, 673 (Iowa 2013) (citing "the principle that every shareholder may reasonably expect to share proportionally in a corporation's gains."); Baker v. Com. Body Builders, Inc., 507 P.2d 387, 397 (Or. 1973) (explaining shareholders have "a legitimate interest in the participation in profits earned by the corporation"). Because share ownership involves multiple undivided interests, an analogy might be drawn to other situations involving multiple owners of a single property—or tenants in common—who have a duty to share profits proportionally and are accountable to the other co-owners.

607 *See* Sneed v. Webre, 465 S.W.3d 169, 191 (Tex. 2015).

608 *Id.* at 190–91 (citing Aransas Pass Harbor Co. v. Manning, 63 S.W. 627, 629 (Tex. 1901)).

in the stockholders."[609] There are certain legal consequences to this ownership structure[610] in which beneficial ownership and legal title are held separately.[611] One who holds the legal title to property for the benefit of the beneficial owner is a trustee,[612] and trustees owe legal duties to the beneficiaries of their trust.[613]

The corporation holds the shareholders' property pursuant to a "contractual relation whereby the corporation acquires and holds the stockholder's investment under express recognition of his right and for a specific purpose."[614] Therefore, although the shareholder may be said to "possess" the stock,[615] the stock is only an undivided interest in property, the actual possession of which is always with the corporation.[616] Texas Courts have held that the corporation is the "custodian of the rights of the stockholders."[617] The "nature of the organization and the relation of the stockholders to the corporation and its property"[618] impose legal duties on the corporation with respect to the stockholder's ownership interest.[619] The relationship, and its accompanying duties, have been characterized as "akin to one of trust,"[620] with the corporation acting as a "quasi-trustee," holding its stock for the benefit of and in trust for its stockholders.[621]

### *2. Rediscovering Corporate Trustee Duties*

One must go back long before the advent of the shareholder oppression doctrine to find

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609 *Sneed*, 465 S.W.3d at 190–91 (quoting Humble Oil & Ref. Co. v. Blankenburg, 235 S.W.2d 891, 894 (Tex. 1951)).

610 It is the shareholder's beneficial ownership of the corporate assets that gives the shareholder standing as a plaintiff in a derivative suit, which as the Texas Supreme Court affirmed in *Sneed* extends to a derivative action brought by shareholder of a parent corporation on behalf of a wholly-owned subsidiary, one of the corporate assets in which the shareholder owns a beneficial interest. *See id.* at 192.

611 *Id.* at 191 (quoting Milner v. Milner, 361 S.W.3d 615, 620–21 (Tex. 2012)).

612 Burns v. Miller, Hiersche, Martens & Hayward, P.C., 948 S.W.2d 317, 322 (Tex. App.—Dallas 1997, writ denied).

613 Herschbach v. City of Corpus Christi, 883 S.W.2d 720, 735 (Tex. App.—Corpus Christi 1994, writ denied).

614 Graham v. Turner, 472 S.W.2d 831, 836 (Tex. Civ. App.—Waco 1971, no writ).

615 Hooks v. Grayson, No. 05-91-00954-CV, 1992 WL 94670, at *3 (Tex. App.—Dallas May 7, 1992, writ denied).

616 Turner v. Cattleman's Trust Co., 215 S.W. 831, 833 (Tex. Comm'n App. 1919, judgm't adopted) (stock at all time remains "in the possession of the corporation"); *see also* Benson v. Greenville Nat'l Exch. Bank, 253 S.W.2d 918, 928–29 (Tex. Civ. App.—Texarkana 1952, writ ref'd n.r.e.) ("[T]he situs of the stock may be at the domicile of the corporation . . . .").

617 Strange v. Houston & T.C.R. Co., 53 Tex. 162, 168 (1880) ("The company is to a certain extent the custodian of the rights of the stockholders, and is responsible for an illegal issuance of stock to their prejudice.").

618 Moroney v. Moroney, 286 S.W. 167, 169 (Tex. Comm'n App. 1926, judgm't affirmed). However, it should be noted that because corporations are set up differently, these rights and interests "may well vary from one corporation to the next." Schautteet v. Chester State Bank, 707 F. Supp. 885, 888 (E.D. Tex. 1988).

619 *See Graham*, 472 S.W.2d at 836.

620 Disco Mach. of Liberal Co. v. Payton, 900 S.W.2d 124, 126 (Tex. App.—Amarillo 1995, writ denied) (The relationship of corporation and shareholder is "akin to one of trust" because of "the contractual relation whereby the corporation acquired and held the stockholder's investment for a specific purpose and under express recognition of his rights accruing in the investment.").

621 Miller v. United States, 78 U.S. 268, 297 (1870) ("A corporation holds its stock, as a quasi trustee, for its stockholders.").

opinions that took any care to define legal relationship between corporation and shareholder and the accompanying duties arising from that relationship. In light of the recent demise of the shareholder oppression doctrine in Texas, those cases are worth a fresh look.

Prior to the adoption of the Uniform Stock Transfer Act[622] by the states, courts imposed "quasi-fiduciary duties" on corporate issuers and their transfer agents to insure that changes in stock registration were not wrongful as against the true owner.[623] These duties arose from the courts' analysis that "a corporation whose stock was transferable only on the books of the company was, to a certain extent at least, a trustee for its shareholders in respect to their stock."[624] Under this older line of case law, courts imposed on the corporation, as trustee, the "duty to exercise reasonable care and diligence to protect [the stockholder's] interests by preventing [wrongful] transfers, and it had to respond in damages."[625] The big change that came with the adoption of the Uniform Stock Transfer Act was to render share certificates freely negotiable—the primary effect of which was to protect good faith purchasers and to ease the risks and burdens that the courts had imposed on corporations when they register a transfer.[626] However, Article 8 of the Uniform Commercial Code does not preempt the common law,[627] and one respected authority has noted that this "large body of case law . . . may still be useful today."[628] In light of the Texas Supreme Court's recent extensive reliance in *Ritchie*[629] and *Sneed*[630] on pre-shareholder oppression cases from the late nineteenth and early twentieth centuries, this exploration seems particularly appropriate.

### *3. Yeaman v. Galveston City Corp.*

One of the clearest statements of the relationship between shareholders and their corporation was given by the Texas Supreme Court in the case of *Yeaman v. Galveston City Corp.*,[631] decided in 1914. That case had its genesis in a property dispute that occurred less than a year after the Battle of San Jacinto. In April of 1837, M. B. Menard, a signer of the Texas Declaration of Independence,[632] who "claimed to own the whole of the league and labor

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[622] TEX. BUS. & COMM. CODE ANN. §§ 8.101–.307 (West 2015) "Chapter 8 of the Texas Business and Commerce Code provides a single set of integrated rules applicable to the transfer of investment securities—shares of stock, bonds, debentures, warrants, and similar instruments." 19 TEX. PRAC.: BUS. ORGS., *supra* note 7, at § 1:13.

[623] 12 FLETCHER CYC. CORP. § 5538 (2015).

[624] *Id.*

[625] *Id.*

[626] *Id.*

[627] *Id.*; *see also* Broadcort Capital Corp. v. Summa Med. Corp., 972 F.2d 1183, 1192 (10th Cir. 1992) (holding that section 8-404 was not the exclusive remedy and that the plaintiff could sue issuer for common law conversion).

[628] *Id.*

[629] Calvert v. Capital Sw. Corp., 441 S.W.2d 247, 255 (Tex. Civ. App.—Austin 1969, writ ref'd n.r.e.); Texarkana Coll. Bowl, Inc. v. Phillips, 408 S.W.2d 537, 539 (Tex. Civ. App.—Texarkana 1966, no writ); Cavitt v. Amsler, 242 S.W. 246, 247 (Tex. Civ. App.—Austin 1922, writ dism'd w.o.j.); Empire Mills v. Alston Grocery Co., 15 S.W. 505, 505–06 (Tex. Civ. App.—1891, no writ).

[630] Blasband v. Rales, 971 F.2d 1034, 1043 (3d Cir. 1992); Hunt v. Bass, 664 S.W.2d 323, 324 (Tex. 1984); Cates v. Sparkman,11 S.W. 846, 848 (Tex. 1889).

[631] Yeaman v. Galveston City Co., 167 S.W. 710 (Tex. 1914).

[632] Margaret Swett Henson, *Michel Branamour Menard*, HANDBOOK OF TEXAS ONLINE, https://tshaonline.org/handbook/online/articles/fme09.

of land[633] granted to him by the republic of Texas, situated on the east end of Galveston Island," got into a dispute with Robert Triplett and two other gentlemen who claimed ownership of the same land.[634] A compromise was reached whereby the parties conveyed the land to Thomas Green, Levi Jones, and William R. Johnson in trust, to be subdivided and sold for the benefit of Triplett and his co-owners.[635] The land was placed in a joint stock company and represented by 1,000 shares of stock, which were then offered to investors in June 1837.[636] The first stockholders' meeting was held in Galveston on April 13, 1838, where the stockholders organized the company, elected directors, and named the company the "Galveston City Company."[637] The company was incorporated in 1841 by an act of the Congress of the Republic of Texas, and "[a]ll stockholders in the joint-stock company were . . . made stockholders in the corporation."[638]

Robert Triplett died in 1853 without having disposed of five of the original trust certificates, which he had never exchanged for share certificates in the corporation.[639] The petition in the lawsuit alleged: "Robert Triplett was a careless man, and left his papers in great confusion. [S]earch among such of his papers as petitioners can find fails to disclose said certificates, and petitioners aver that said 5 certificates are lost or destroyed."[640] His descendants did not discover his ownership of the original five certificates until August 1909,[641] at which time they sued the Galveston City Company and its president, individually, to establish their rights as stockholders, for an accounting and recovery of 72 years of dividends, and to enjoin the proposed dissolution of the corporation by the majority of its stockholders.[642]

The Texas Supreme Court first had to determine whether Triplett had been a shareholder in the corporation or had only had the right to become one—a right which would have been lost due to the statute of limitations—and to determine the legal effect of his never having received stock certificates in the corporation. The Court held that Triplett had become a stock holder by virtue of having fulfilled his subscription agreement[643] and that his failure to obtain a stock certificate was irrelevant:

> [I]n a corporation the certificate of stock is not the stock itself; it is but a muniment of title, an evidence of the ownership of the stock. It is not necessary to a subscriber's complete ownership of the stock. He becomes a full stockholder, certainly where he has performed his obligation, and possession all of a stockholder's rights, even if no

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633 4,605 acres. *Yeaman*, 167 S.W. at 712.

634 *Id.* at 711.

635 *Id.*

636 *Id.* at 712.

637 *Id.* at 713.

638 *Id.* at 715.

639 *Id.* at 715.

640 *Id.* at 716.

641 *Id.*

642 *Id.* at 711.

643 "No principle of law is better settled than that which affirms that the payment of his subscription by an original subscriber to the capital stock of a corporation constitutes him a stockholder, and that, as before stated, regardless of the issuance of any certificate." *Id.* at 720.

certificate is issued to him at all.[644]

The Court then turned to the thornier issue of limitations and the plaintiffs' 72-year delay in asserting their rights—particularly, whether the corporation could be forced to pay 72 years' worth of dividends. The Court's answer was based on the nature of the legal relationship between stockholder and corporation and the legal duties that the corporation owes to its stockholders arising from that relationship.

The Court held that a corporation "is a trustee for the interests of its shareholders in its property, and is under the obligation to observe its trust for their benefit."[645]

> [T]he trusteeship of a corporation for its stockholders is that of an acknowledged and continuing trust. It cannot be regarded of a different character. It arises out of the contractual relation whereby the corporation acquires and holds the stockholder's investment under express recognition of his right and for a specific purpose. It has all the nature of a direct trust.[646]

Because the law imposes on the corporation the duties of a trustee, the Court held: "Its possession is friendly, and not adverse, and the shareholder is entitled to rely upon its not attempting to impair his interest."[647] Because the shareholder is the beneficiary of the trust, "[h]e is chargeable with no vigilance to preserve his stock or its fruits from appropriation by the corporation, but may confide in its protection for their security."[648] Therefore, the court rejected the corporation's defense of limitations on the shareholder's descendants' 72-year-old claims for cancellation of their shares and for an accounting and for payment of dividends.[649] "And when a corporate act is invoked as a repudiation of a shareholder's stock or a conversion of its profits, before affecting his rights with limitation, it is only just to require that he or those standing in his stead have notice of it."[650] "Statutes of limitation have no application until there is a clear and unequivocal disavowal of the trust, and notice of it brought to the cestui que trust."[651]

While *Yeaman* is a very old case,[652] the legal relationship between a corporation and its shareholders as a particular type of trust has been often repeated, never denied or limited, and is very well established in Texas case law.[653] More recent Texas cases continue to hold that the

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644 *Id.*

645 *Id.* at 723.

646 *Id.*

647 *Id.*

648 *Id.*

649 *Id.* ("[T]heir suit is not barred, either to enforce their rights as stockholders, or for an accounting and the recovery of profits, or such amount as these shares would be entitled to as dividends.").

650 *Id.*

651 *Id.* at 723–24.

652 Although not nearly as old as Cates v. Sparkman, 11 S.W. 846, 849 (Tex. 1889) on which both *Ritchie* and *Sneed* relied heavily. Sneed v. Webre, 465 S.W.3d 169, 173 (Tex. 2015); Ritchie v. Rupe, 443 S.W.3d 856, 884 (Tex. 2014).

653 *See* Disco Mach. of Liberal Co. v. Payton, 900 S.W.2d 124, 126 n.2 (Tex. App.—Amarillo 1995, writ denied) ("Historically, the relationship between corporation and shareholder was akin to one of trust."); Hinds v. Sw.

trust relationship "arises out of the contractual relation whereby the corporation acquires and holds the stockholder's investment,"[654] and that the corporation holds legal title to its assets and business,[655] but that legal title is held for the benefit of the shareholders, who are the equitable and beneficial owners of the corporation's assets.[656] "In a larger or real sense the stockholders of a corporation are the beneficial owners of its corporate properties."[657]

With respect to a shareholder's right to participate in a corporation's profits through dividends, the *Yeaman* Court wrote: "There can be no substantial difference between the trusteeship of a corporation as it relates to the stock of a shareholder and its duty to him in respect to the profits or dividends upon his stock."[658] And, as the *Patton* Court would hold

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Sav. Ass'n of Houston, 562 S.W.2d 4, 5 (Tex. Civ. App.—Beaumont 1977, writ ref'd n.r.e.) ("[T]rusteeship of a corporation for its stockholders is that of an acknowledged and continuing trust . . . ."); Graham v. Turner, 472 S.W.2d 831, 836 (Tex. Civ. App.—Waco 1971, no writ) ("the relation of a corporation to its stockholders is that of a trustee of a direct trust."); Rex Ref. Co. v. Morris, 72 S.W.2d 687, 691 (Tex. Civ. App.—Dallas 1934, no writ) ("A corporation stands in the relation of a trustee to its stockholders, so where it appears that a stockholder's ownership is challenged by the company, he may maintain an action to establish his ownership."); Green v. Galveston City Co., 191 S.W. 182, 185 (Tex. Civ. App.—Galveston 1916, writ ref'd) ("It is also true that a corporation stands in the relation of trustee to the owners of its stock.").

654 *Graham*, 472 S.W.2d at 836. *See also Disco Mach.*, 900 S.W.2d at 126 ([T]he relationship of corporation and shareholder is "akin to one of trust" because of "the contractual relation whereby the corporation acquired and held the stockholder's investment for a specific purpose and under express recognition of his rights accruing in the investment.").

655 Rapp v. Felsenthal, 628 S.W.2d 258, 260 (Tex. App.—Fort Worth 1982, writ ref'd n.r.e.).

656 *See* Cotten v. Weatherford Bancshares, Inc., 187 S.W.3d 687, 697 (Tex. App.—Fort Worth 2006, pet. denied); *In re* Estate of Trevino, 195 S.W.3d 223, 230 (Tex. App.—San Antonio 2006, no pet.); Martin v. Martin, Martin & Richards, Inc., 12 S.W.3d 120, 124 (Tex. App.—Fort Worth 1999, no pet.); *Rapp*, 628 S.W.2d at 260; Gossett v. State, 417 S.W.2d 730 (Tex. Civ. App.—Eastland 1967, writ ref'd n.r.e.). "[M]any other cases refer to a shareholder or stockholder as having a beneficial interest in a company." Hahn v. R.R. Comm'n of Tex., No. 03-07-00183-CV, 2009 WL 2341859, at *3 (Tex. App.—Austin July 30, 2009, pet. denied) (mem. op.) (citing McAlister v. Eclipse Oil Co., 98 S.W.2d 171, 176 (Tex. 1936)) ("[S]trictly speaking, the ownership of the stock does not carry with it the equitable title to the corporate property. This simply means, however, that the stockholders have no right to require the corporation to convey to them the legal title to the corporate property. In a larger or real sense the stockholders of a corporation are the beneficial owners of its corporate properties."); Auto. Mortg. Co. v. Ayub, 266 S.W. 134, 135–36 (Tex. 1924) (stating that stockholder is beneficial owner of corporate assets and does not have direct interest in corporate property; while company is operating, company has title of corporate property; stockholder has equitable right to corporate assets if company ceases to operate and assets remain after creditors are satisfied); McClory v. Schneider, 51 S.W.2d 738, 741–42 (Tex. Civ. App.—Amarillo 1932, writ dism'd w.o.j.) (stockholder "owns no part of the capital, and is not the owner nor entitled to the possession of any definite portion of its property or assets"; stock purchaser does not acquire title to corporate property but simply acquires "beneficial interest" in company). *See also* Berl v. Crutcher, 60 F.2d 440, 444 (5th Cir. 1932) ("Generally speaking, a corporation is a separate entity distinct from the stockholders, but as between itself and its stockholders this is a mere fiction, and the equitable ownership of all its property is in the stockholders, subject to the prior rights of creditors."); *In re* Lawler, 50 B.R. 110, 118 (Bankr. N.D. Tex. 1985) ("as between the corporation and its shareholders, the latter have an equitable interest in assets held by the former."); Humble Oil & Ref. Co. v. Blankenburg, 235 S.W.2d 891, 894 (Tex. 1951) ("As the owner of 90 shares of the stock petitioner is the beneficial owner of its proportionate part of the corporation's assets and thus is the beneficial owner of an undivided interest in the property for which it sues.").

657 *McAlister*, 98 S.W.2d at 176. "[W]hen this concern was chartered and the properties above described conveyed to it, it became the corporate owner thereof, but the real or beneficial owners of such property were the three stockholders in the proportion in which they held the stock of the corporation." *Id.*

658 Yeaman v. Galveston City Co., 167 S.W. 710, 724 (Tex. 1914).

about forty years later, "the malicious suppression of dividends is a wrong akin to breach of trust, for which the courts will afford a remedy."[659] The *Patton* Court's use of the phrase "breach of trust" to describe suppression of dividends was no accident, and it was not an archaic way of referring to the fiduciary duties that directors owe only to the corporation and not to the minority shareholders.[660] The phrase "breach of trust" was first used in this context in the 1855 United States Supreme Court case of *Dodge v. Woolsey*,[661] in which that Court wrote:

> It is now no longer doubted, either in England or the United States, that courts of equity, in both, have a jurisdiction over corporations, at the instance of one or more of their members; to apply preventive remedies by injunction, to restrain those who administer them from doing acts which would amount to a violation of charters, or to prevent any misapplication of their capitals or profits, which might result in lessening the dividends of stockholders, or the value of their shares, as either may be protected by the franchises of a corporation, if the acts intended to be done create what is in the law denominated a breach of trust.[662]

The holding in *Dodge v. Woolsey* specifically related to ultra vires acts that "might result in lessening the dividends," but the Texas Supreme Court, in later reviewing that landmark case, wrote:

> After repeated efforts minority stockholders were successful in establishing their right to relief in courts of equity. It was first established in America in the case of *Dodge v. Woosley*, decided by the Supreme Court of the United States in 1855. . . . The doctrine announced [] has become thoroughly established as the law both in England and America. The rule in this regard is tersely stated by Mr. Cook in his splendid treatise on Stock and Stockholders, 'that where corporate directors have permitted a breach of trust either by their fraud, ultra vires acts, or negligence.'[663]

Over the years, courts frequently listed "breach of trust" as one of the grounds on which a court of equity might disturb a decision by a board of directors regarding dividends.[664] Both of the cases on which the *Patton* Court principally relied as authority for its substantive holding

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659 Patton v. Nicholas, 279 S.W.2d 848, 854 (Tex. 1955).

660 *See* Ritchie v. Rupe, 443 S.W.3d 856, 884 n.49 (Tex. 2014).

661 Dodge v. Woolsey, 59 U.S. 331 (1855).

662 *Id.* at 341.

663 Pratt-Hewit Oil Corp. v. Hewit, 52 S.W.2d 64, 65–66 (Tex. 1932) (citations omitted).

664 *See, e.g.,* Penn v. Pemberton & Penn, Inc., 53 S.E.2d 823, 828 (Va. 1949) ("The general rule is that in the absence of a special contract or statute the board of directors, in its discretion, determines whether to declare dividends on the stock, or to apply the earnings and surplus to operating capital, or to some other corporate purpose. If the directors act in good faith, a court of equity usually will not interfere with the exercise of their discretion. However, if the action of the board in refusing to declare a dividend when there are sufficient earnings or surplus not necessarily needed in the business, is so arbitrary, or so unreasonable, as to amount to a breach of trust, such action is subject to judicial review."); Gehrt v. Collins Plow Co., 156 Ill. App. 98, 102 (Ill. App. Ct. 1910) ("It requires a very strong case to induce a court of equity to order the directors to declare a dividend, inasmuch as equity has no jurisdiction unless fraud or a breach of trust is involved.").

that a court may grant equitable relief for a suppression of dividends[665] quote the "breach of trust" language from *Dodge v. Woolsey*.[666] The *Miner* case, in particular, added this application of the "breach of trust" notion in the context of suppression of dividends:

> The present case furnishes an instance of gross abuse of trust. Must the cestui que trust be committed to the domination of a trustee who has for seven years continued to violate the trust? The law requires of the majority the utmost good faith in the control and management of the corporation as to the minority. It is of the essence of this trust that it shall be so managed as to produce for each stockholder the best possible return for his investment. The trustee has so far absorbed all returns.[667]

## B. Legal Duties Arising from the Trust Relationship

Stock is an abstract concept, an intangible set of rights and interests, not a physical thing. Ownership of stock may be evidenced by a written stock certificate and a written notation on the corporate books; however, the evidence of the thing is not the thing itself.[668] Ultimately, stock ownership resides in the corporation's acknowledgement of the existence of the ownership interest because the corporation has legal title and physical possession of its assets and enterprise. The stockholder has only an intangible right—a claim on the corporation—which involves the various property rights just discussed. That "claim" is meaningless unless the law recognizes enforceable legal duties to each shareholder.

### *1. Corporate Trustee Duties*

Generally speaking, the duties that the law imposes on trustees are extremely strict. A trustee owes a trust beneficiary an unwavering duty of good faith, fair dealing, loyalty, and fidelity over the trust's affairs and its corpus.[669] The Texas Supreme Court has written:

> When persons enter into fiduciary relations, each consents, as a matter of law, to have his conduct towards the other measured by the standards of the finer loyalties exacted by courts of equity. That is a sound rule and should not be whittled down by exceptions. The rule is general in its use and is fundamental. It is for the benefit of the cestui que trust and undertakes to enforce the duty of loyalty on the part of the trustee by prohibiting him from using the advantage of his position to gain any benefit for himself at the expense of his cestui que trust and from placing himself in any position where his self-interest will or may conflict with his obligations as trustee.[670]

However, the application of those duties in the corporate context must be a little different

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665 *See* Patton v. Nicholas, 279 S.W.2d 848, 855 (Tex. 1955) (citing Tower Hill-Connellsville Coke Co. of W. Va. v. Piedmont Coal Co., 64 F.2d 817 (4th Cir. 1933)); Miner v. Belle Isle Ice Co., 53 N.W. 218 (Mich. 1892).

666 *See Tower Hill-Connellsville*, 64 F.2d at 826; *Miner*, 53 N.W. at 224.

667 *Miner*, 53 N.W. at 224.

668 Yeaman v. Galveston City Co., 167 S.W. 710 (Tex. 1914).

669 Herschbach v. City of Corpus Christi, 883 S.W.2d 720, 735 (Tex. App.—Corpus Christi 1994, writ denied); Ames v. Ames, 757 S.W.2d 468, 476 (Tex. App.—Beaumont 1988), *aff'd*, 776 S.W.2d 154 (Tex. 1989).

670 Slay v. Burnett Trust, 187 S.W.2d 377, 377–78 (Tex. 1945).

from the application to a human trustee. In the corporate context, the strict duties of loyalty and care, which concern the management and control of the trust assets, are imposed on the directors and apply as to the corporation (the trust fund as a whole). Individual shareholders are not owed those duties apart from the corporation and have no ability to bring a claim on their own behalf for breach of those duties. The exception to this rule is that when the corporation is unable to enforce those duties, then the beneficial owners may bring a derivative claim on behalf of the corporation to do so. Nevertheless, as noted in the discussion above, shareholders have individual rights and interests of that are distinct from those of the corporation, and the corporation as trustee owes duties to the shareholder with respect to those rights and interests.

***a.*** *Duty to Acknowledge and Preserve Ownership Rights*

As the Texas Supreme Court held in *Yeaman*, the corporation has a fiduciary duty to recognize, to respect, and not to attempt to interfere with a shareholder's ownership: "[T]he shareholder is entitled to rely upon [the corporation's] not attempting to impair his interest. He . . . may confide in its protection for their security."[671] The corporation "holds bare legal title"[672] but it must recognize always that the shareholder is the "real owner."[673] Absent some statutory or charter power, or the express consent of the shareholder, a corporation has no authority to forfeit a shareholder's stock.[674]

A trustee is also under a duty to the beneficiaries to administer the trust solely in the interest of the beneficiaries.[675] A shareholder's stock ownership includes a number of rights and interests, and the corporation has a duty not to "impair his interest."[676] Trust law recognizes that the profits belong to the beneficiaries, not to the trustee.[677] Therefore, the corporation's duty to its shareholders is to "to observe its trust for their benefit"[678] and to preserve both the stock ownership and its "fruits."[679]

***b.*** *Duty of Impartiality*

Most significant of the trustee duties in the context of minority shareholders in a closely-

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671 *Yeaman*, 167 S.W. at 723.

672 Sharma v. Routh, 302 S.W.3d 355, 366 (Tex. App.—Houston [14th Dist.] 2009, no pet.).

673 Burns v. Miller, Hiersche, Martens & Hayward, P.C., 948 S.W.2d 317, 322 (Tex. App.—Dallas 1997, writ denied).

674 *See Yeaman*, 167 S.W. at 723 ("We are unwilling to affirm that, in the absence of some statutory or charter power, or express consent to that effect, a corporation has any authority to forfeit a stockholder's shares upon such a ground.").

675 RESTATEMENT (SECOND) OF TRUSTS §170(1) (2016); Ditta v. Conte, 298 S.W.3d 187, 191 (Tex. 2009) ("High fiduciary standards are imposed upon trustees, who must handle trust property solely for the beneficiaries' benefit.").

676 *Yeaman*, 167 S.W. at 723.

677 Steves v. United Servs. Auto. Ass'n, 459 S.W.2d 930, 936 (Tex. Civ. App.—Beaumont 1970, writ ref'd n.r.e.) ("profit from dealing with the property of the Trust is the property of the beneficiaries, not the trustee"); Hamman v. Ritchie, 547 S.W.2d 698, 710 (Tex. Civ. App.—Fort Worth 1977, writ ref'd n.r.e.) ("profits are the entitlement of the trust benefactor").

678 *Yeaman*, 167 S.W. at 723.

679 *Id.*

held corporation is the corporate trustee's duty of impartiality towards multiple beneficiaries. When there are two or more beneficiaries of a trust, the trustee is under a strict duty to deal impartially with them.[680] Shares are fungible. Every share of the same class gets the same vote, the same dividend, and is entitled to the same treatment.[681] In a dispute among shareholders over who will control the corporation, the corporation itself must remain strictly neutral.[682]

> Nothing can be more unjustifiable and dishonorable than an attempt on the part of those holding a majority of the shares in a corporation to place their nominees in control of the company, and then to use their control for the purpose of obtaining advantage to themselves at the expense of the minority. It would be a conspiracy to commit a breach of trust. The directors of a corporation are bound to administer its affairs with strict impartiality, in the interest of all the shareholders alike; and the inability of the minority to protect themselves against unauthorized acts, performed

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[680] Brown v. Scherck, 393 S.W.2d 172, 181 (Tex. Civ. App.—Corpus Christi 1965, no writ) ("Where there are several beneficiaries, the trustee owes the same fiduciary duty to all of them to protect their respective interests, without partiality or favor to some beneficiaries at the expense of the others."); duPont v. S. Nat'l Bank of Hous., 771 F.2d 874, 887 n.12 (5th Cir. 1985) ("has a duty to deal impartially with the beneficiaries of the trust"); RESTATEMENT (SECOND) OF TRUSTS § 183 (1959) ("When there are two or more beneficiaries of a trust, the trustee is under a duty to deal impartially with them."); RESTATEMENT (THIRD) OF TRUSTS § 79(1)(a) (2007) (a "trustee has a duty to administer the trust in a manner that is impartial with respect to the various beneficiaries of the trust[;] . . . the trustee must act impartially and with due regard for the diverse beneficial interests created by the terms of the trust."). This common-law principal is codified at TEX. PROP. CODE ANN. § 117.008 (West 2015) ("If a trust has two or more beneficiaries, the trustee shall act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries."). *See also* Varity Corp. v. Howe, 516 U.S. 489, 514 (1996) ("The common law of trusts recognizes the need to preserve assets to satisfy future, as well as present, claims and requires a trustee to take impartial account of the interests of all beneficiaries."); Chauffeurs, Teamsters & Helpers, Local No. 391 v. Terry, 494 U.S. 558, 586 (1990) ("Trust law, in a similar manner, long has required trustees to serve the interests of all beneficiaries with impartiality."); Palmer v. Chamberlin, 191 F.2d 532, 545 (5th Cir. 1951) ("[T]he trustees' duty was to act impartially between all beneficiaries . . . ."); Pierre v. Conn. Gen. Life Ins. Co., 932 F.2d 1552, 1562 (5th Cir. 1991) ("duty to deal impartially with the beneficiaries of the trust"); Miss. Valley Trust Co. v. Buder, 47 F.2d 507, 509 (8th Cir. 1931) ("The duty of a trustee to act with impartiality toward the several cestuis que trustent must be conceded, but the law permits a reasonable and practical course of conduct and does not set an impossible or extreme standard."); *In re* Estate of Stuchlik, 857 N.W.2d 57, 70 (Neb. 2014) ("If a trust has two or more beneficiaries, a trustee has a duty of impartiality among beneficiaries. This includes a duty to 'act impartially in investing, managing, and distributing the trust property, giving due regard to the beneficiaries' respective interests."); Harrison v. Marcus, 486 N.E.2d 710, 714 n.11 (Mass. 1985) ("Where there are successive beneficiaries, the trustees 'owe[ ] a duty to them to administer the trust with impartial consideration for the interests of all the beneficiaries.'"); Estate of Sewell, 409 A.2d 401, 402 (Pa. 1979) ("It is axiomatic that '(w)hen there are two or more beneficiaries of a trust, the trustee is under a duty to deal impartially with them.'"); Johnson v. Johnson, 45 N.W.2d 573, 574 (Iowa 1951) ("A trustee must act at all times in good faith in administering the trust and impartially between the several beneficiaries thereof."); Koretzky's Estate v. Kislak, 86 A.2d 238, 250 (N.J. 1951) ("It is the duty of trustees to deal impartially with beneficiaries."); Patterson v. Old Dominion Trust Co., 140 S.E. 810, 813 (Va. 1927) ("In the management of trust property, a trustee should always conduct himself with strict neutrality, favoring none of the parties to the suit, and endeavor to obtain an impartial direction in all cases of doubt or difficulty, and should also preserve and protect the trust fund for the benefit of all interested in the distribution thereof.").

[681] *See* TEX. BUS. ORGS. CODE ANN. § 21.152(c) (West 2015) ("Shares of the same class must be identical in all respects unless the shares have been divided into one or more series. If the shares of a class have been divided into one or more series, the shares may vary between series, but all shares of the same series must be identical in all respects.").

[682] *See* Alexander v. Sturkie, 909 S.W.2d 166, 170 (Tex. App.—Houston [14th Dist.] 1995, writ denied).

> with the connivance of the majority, renders their right to the protection of the courts the clearer.[683]

The most common conduct challenged in oppression cases is manipulation of the control over the corporation to make the majority's investment proportionally more valuable than the minority's or otherwise to use the minority shareholder's own corporation against him to disadvantage the minority relative to the majority.[684] Actions taken by the corporation that result in the impairment of minority rights and interests to the benefit of the majority shareholder or result in the majority shareholder enjoying a disproportionate share of the profits or capital value to the detriment of the minority violate the duty of impartiality. Thus, a refusal to issue dividends in an effort to harm the minority shareholders is a "wrong akin to breach of trust."[685] This concept was accepted and reinforced in the *Ritchie* opinion by the majority's argument that the corporation's interests are not identical to the individual interests of its majority shareholders, and that officers and directors controlling a corporation have a duty "to the corporation and its shareholders collectively, not any individual shareholder or subgroup of shareholders, even if that subgroup represents a majority of the ownership."[686] "We do not determine the best interest of the corporation by examining only the interest of its majority shareholder(s)."[687]

### *c. Duty to Disclose and Account*

The shareholders own the corporation and are the equitable or beneficial owners of all property possessed by the corporation, including all the information and all the records.[688] Those in charge of the corporation are merely the agents ultimately of the stockholders who are the real owners, and the owners are entitled to information as to the manner in which the corporate business is conducted.[689]

> While the corporation holds the legal title to its property, the stockholders are deemed the real and beneficial owners thereof and, as such, are entitled to information

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683 Memphis & C. R. Co. v. Wood, 7 So. 108, 112 (Ala. 1889).

684 *See* Boehringer v. Konkel, 404 S.W.3d 18, 28 (Tex. App.—Houston [1st Dist.] 2013, no pet.) (oppression by majority's $20,000 per month salary increase, which resulted in a "de facto dividend to the exclusion of . . . the minority shareholder"); Davis v. Sheerin, 754 S.W.2d 375, 382 (Tex. App.—Houston [1st Dist.] 1988, writ denied) (oppression by payment of "informal dividends" only to the majority and use of corporate funds to pay the majority shareholder's legal fees).

685 Patton v. Nicholas, 279 S.W.2d 848, 854 (Tex. 1955).

686 Ritchie v. Rupe, 443 S.W.3d 856, 885 n.5 (Tex. 2014). To support this argument, the *Ritchie* opinion cites Redmon v. Griffith, 202 S.W.3d 225, 233 (Tex. App.—Tyler 2006, pet. denied); Somers *ex rel.* EGL v. Crane, 295 S.W.3d 5, 11 (Tex. App.—Houston [1st Dist.] 2009, no pet.); Lindley v. McKnight, 349 S.W.3d 113, 124 (Tex. App.—Fort Worth 2011, no pet.); Hoggett v. Brown, 971 S.W.2d 472, 488 (Tex. App.—Houston [14th Dist.] 1997, pet. denied).

687 *Ritchie*, 443 S.W.3d at 885 n.53 (citing Holloway v. Skinner, 898 S.W.2d 793, 797 (Tex. 1995) as "holding that corporate officer and majority shareholder could be held liable for acting 'in a manner that served his interests at the expense of the other shareholders' because his interests and the corporation's were not necessarily aligned.").

688 *See* Cotten v. Weatherford Bancshares, Inc., 187 S.W.3d 687, 697 (Tex. App.—Fort Worth 2006, pet. denied).

689 Johnson Ranch Royalty Co. v. Hickey, 31 S.W.2d 150, 153 (Tex. Civ. App.—Amarillo 1930, writ ref'd).

> concerning the management of the property and business they have confided to the officers and directors of the corporation as their agents. A stockholder's assertion of right to inspect the corporation's books and records is sometimes said to be one merely for the inspection of what is his own.[690]

A shareholder's right to information about the corporation reflects the fundamental duties of disclosure owed by trustees.[691] "In general, the common-law trustee of an irrevocable trust must produce trust-related information to the beneficiary on a reasonable basis, though this duty is sometimes limited and may be modified by the settlor."[692] Corporations are required by statute to keep records and accounts and to permit shareholders to inspect the records.[693] However, the shareholder's right to access corporate records is meaningless if those records are not kept, or are not accurate. The corporation as a trustee, has a broader duty to keep complete and accurate records to be able to meet its duty to account to its beneficiaries for the management of their property.[694] The trustee's duty regarding trust-related information is stated as follows:

> A. Duty to keep accounts. The trustee is under a duty to keep accounts showing in detail the nature and amount of the trust property and the administration thereof.
>
> B. Effect of failure to keep accounts. If the trustee fails to keep proper accounts, he is liable for any loss or expense resulting from his failure to keep proper accounts. The burden of proof is upon the trustee to show that he is entitled to the credits he claims, and his failure to keep proper accounts and vouchers may result in his failure to establish the credits he claims.[695]

"The trustee should have at least given an accurate and complete statement of the trust estate, free from any suggestion of fraud."[696]

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[690] State *ex rel.* G.M. Gustafson Co. v. Crookston Trust Co., 22 N.W.2d 911, 915–16 (Minn. 1946); *accord* Guthrie v. Harkness, 199 U.S. 148, 155 (1905).

[691] *See* RESTATEMENT (SECOND) OF TRUSTS § 172 (2016) (duty to the beneficiary to keep and render clear and accurate accounts with respect to the administration of the trust); *id.* § 173 (duty to the beneficiary to give him upon his request at reasonable times complete and accurate information as to the nature and amount of the trust property, and to permit him or a person duly authorized by him to inspect the subject matter of the trust and the accounts and vouchers and other documents relating to the trust).

[692] United States v. Jicarilla Apache Nation, 564 U.S. 162, 183 (2011).

[693] *See* TEX. BUS. ORGS. CODE ANN. §§ 3.151–.153, 21.173, 218–22 (West 2012).

[694] *See* Huie v. DeShazo, 922 S.W.2d 920, 923 (Tex. 1996) (trustees and executors owe beneficiaries "a fiduciary duty of full disclosure of all material facts known to them that might affect [the beneficiaries'] rights."); Faulkner v. Bost, 137 S.W.3d 254, 259 (Tex. App.—Tyler 2004, no pet.) ("A trustee shall maintain a complete and accurate accounting of the administration of the trust."); Shannon v. Frost Nat'l Bank, 533 S.W.2d 389, 393 (Tex. Civ. App.—San Antonio 1975, writ ref'd n.r.e.) ("[I]t is well settled that a trustee owes a duty to give to the beneficiary upon request complete and accurate information as to the administration of the trust" and "to make a frank and dull disclosure of all the information which it had.").

[695] RESTATEMENT (SECOND) OF TRUSTS § 172. *See also* Corpus Christi Bank & Trust v. Roberts, 587 S.W.2d 173, 182 (Tex. Civ. App.—Corpus Christi 1979), *aff'd*, 597 S.W.2d 752 (Tex. 1980); Harris Cty. v. Wilkinson, 507 S.W.2d 848, 851 (Tex. Civ. App.—Houston [14th Dist.] 1974, writ ref'd n.r.e.).

[696] *Roberts*, 587 S.W.2d at 181–82. *See* Conrad v. Judson, 465 S.W.2d 819, 828 (Tex. Civ. App.—Dallas 1971, writ ref'd n.r.e.) *cert. denied*, 405 U.S. 1041 (1972); Cook v. Peacock, 154 S.W.2d 688, 691 (Tex. Civ. App.—

### *2. Objections to this Analysis*

The concept of "fiduciary duties" owed by the corporation to its shareholders has drawn considerable hostility from some commentators and courts in other jurisdictions. In *Ritchie*, the Texas Supreme Court, in addressing a different legal issue, quoted one commentator who expressed extreme doubt as to fiduciary duties owed by the corporation:

> The very idea that a corporation has a fiduciary duty to individual shareholders is troubling. The corporation can act only through its board of directors, officers, employees, and other agents. These actors are obligated to act in the best interests of the corporation, which may not coincide with the best interests of an individual shareholder transacting business with the corporation. There is no reason to impose a fiduciary obligation on these actors to act in the best interests of an individual shareholder when that shareholder proposes a course of conduct not in the best interests of the corporation.[697]

This concern, however, presents a false dilemma. First, the factual situation contemplated is a "shareholder transacting business with the corporation" where the "best interests of the individual shareholder" in that transaction do not coincide with the "best interests of the corporation." For example, a corporation might need to rent a warehouse, and a minority shareholder might have a suitable property. In that situation, the minority shareholder is not dealing with the corporation as a shareholder but as a prospective landlord. The interests of the shareholder (receiving highest rent) and the interests of the corporation (paying lowest rent) are inherently in conflict. Nothing in *Yeaman* or in any case decided under the shareholder oppression doctrine suggests in the slightest that the corporation would be breaching a duty to the minority shareholder by renting a different warehouse that was better and cheaper. However, when a corporation seeks to redeem or repurchase shares from a minority shareholder—the one business transaction between corporation and shareholder where the shareholder is acting in his capacity as a shareholder—the corporation indisputably owes fiduciary duties to the individual shareholder.[698]

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Eastland 1941, writ ref'd w.o.m.).

[697] Ritchie v. Rupe, 443 S.W.3d 856, 890 n.62 (Tex. 2014) (quoting Mark J. Loewenstein & William K.S. Wang, *The Corporation as Insider Trader*, 30 DEL. J. CORP. L. 45, 52 (2005)). The Supreme Court cites this commentator only on the issue of whether officers and directors owe fiduciary duties to individual shareholders:

> Imposing on directors and officers a common-law duty not to act 'oppressively' against individual shareholders is the equivalent of, or at least closely akin to, imposing on directors and officers a fiduciary duty to individual shareholders. We have not previously recognized a formal fiduciary duty to individual shareholders, and we believe that better judgment counsels against doing so.

*Id.* at 890. The Supreme Court has most certainly recognized that corporations do owe the same types of duties—i.e., fiduciary duties—to shareholders as trustees owe to beneficiaries of the trust. *See, e.g.*, Yeaman v. Galveston City Co., 167 S.W. 710, 724 (Tex. 1914). ("There can be no substantial difference between the trusteeship of a corporation as it relates to the stock of a shareholder and its duty to him in respect to the profits or dividends upon his stock.").

[698] Allen v. Devon Energy Holdings, L.L.C., 367 S.W.3d 355, 355 (Tex. App.—Houston [1st Dist.] 2012, pet. granted, judgm't vacated w.r.m.); Miller v. Miller, 700 S.W.2d 941, 945 (Tex. App.—Dallas 1985, writ ref'd n.r.e.). The *Ritchie* opinion specifically cites this holding in *Devon* as an example of current remedies being adequate. *See Ritchie,* 442 S.W.3d at 888 n.56.

Second, what is at issue is not a potential conflict between the best interests of the corporation and the best interests of an individual shareholder, but what legal duties do corporations owe to each and every shareholder by virtue of the fact that they are shareholders of the corporation. If, for example, a corporation owed a duty to allow its shareholders to vote and to be bound by the result,[699] then a corporation would be held to that legal duty regardless of whether the management of the corporation thought that it would be in the "best interest of the corporation" to disenfranchise certain shareholders. The corporation could not unilaterally cancel a troublesome minority shareholder's stock because management sincerely (and even correctly) believed that the corporation would be better off without him. The corporation would not be permitted to pay dividends to all shareholders except one, based on the determination that the corporation needed the money, and that the best interests of the corporation trumped the best interests of an individual shareholder.

A number of courts have also resisted the idea that corporations owe "fiduciary duties" to shareholders based on the concern that this doctrine would result in vicarious liability to the corporation for wrongdoing initiated by and executed by its officers, directors or other shareholders.[700] The Sixth Circuit has stated:

> Liability for breach of the directors' fiduciary obligation could not possibly run against the corporation itself, for this would create the absurdity of satisfying the shareholders' claims against the directors from the corporation, which is owned by the shareholders. There is not, and could not conceptually be any authority that a corporation as an entity has a fiduciary duty to its shareholders.[701]

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[699] *See* TEX. BUS. ORGS. CODE ANN. § 21.401 (West 2006) (business affairs managed through board of directors).

[700] Many jurisdictions have held that there is no respondeat superior liability on a corporation for a breach of fiduciary duty by its directors. *See* CCBN.Com, Inc. v. Thomson Fin., Inc., 270 F. Supp. 2d 146, 151–52 (D. Mass. 2003); U.S. Airways Grp., Inc. v. British Airways P.L.C., 989 F. Supp. 482, 494 (S.D.N.Y. 1997) ("[T]he imposition of respondeat superior liability on a corporation for breach of fiduciary duty by its directors on the board of another corporation would completely undermine Delaware corporate law, which limits such fiduciary duty to majority and controlling shareholders."); *cf.* Med. Self Care, Inc. v. Nat'l Broad. Co., Inc., No. 01-CIV-4191, 2003 WL 1622181, at *7 (S.D.N.Y. Mar. 28, 2003) (citing *U.S. Airways Group* and rejecting theory under California law); *see also* RESTATEMENT (SECOND) OF AGENCY §§ 140, 212 (1958). *But see In re* Papercraft Corp., 165 B.R. 980, 991 (Bankr. W.D. Pa. 1994) (accepting theory in case applying Pennsylvania law), *vacated on other grounds*, 187 B.R. 486 (Bankr. W.D. Pa. 1995), *rev'd on other grounds*, 211 B.R. 813 (W.D. Pa. 1997).

[701] Radol v. Thomas, 772 F.2d 244, 258 (6th Cir. 1985). *See* Jordan v. Global Natural Res., Inc., 564 F. Supp. 59, 68 (S.D. Ohio 1983) ("We conclude, however, that a corporation as an entity has no fiduciary duty to its shareholders as a matter of law. We have engaged in extensive research and have found nothing to indicate that a fiduciary relationship exists between a corporation and its shareholders. Rather, a corporation is a legal entity created and regulated by statute in derogation of the common law. The rights and obligations of a corporation and its shareholders are defined by statute and remedies are provided for breach of statutory duties. We can find no authority that would allow this Court to impose a common law fiduciary duty on the part of Global to its shareholders and we, therefore, decline to do so. . . . A corporation, because of its nature, may act only through its officers and agents. It may, therefore, be held vicariously liable for the acts of its officers and agents acting within the scope of their actual or apparent authority under the doctrine of respondeat superior.") (citations omitted); *see also* Holloway v. Howerdd, 536 F.2d 690, 695 (6th Cir. 1976) (applying traditional agency principles to determine liability).

There is widespread agreement with this position.[702] However, this objection is directed at a different set of duties than those recognized in *Yeaman*. The officers' and directors' duties run to the corporation. Liability for breach of those duties, say, stealing corporate funds, is to the corporation (and thus to all of the shareholders collectively). Of course, it is absurd to say that a corporation is liable to itself when the president steals its money. However, if the corporation owes a legal duty to a shareholder, then there is absolutely nothing "absurd" about a corporation being held liable to injured parties for the conduct of its agents that violate that legal duty. A corporation can only act through its human agents[703] and make decisions through its human management.[704] Every instance of corporate liability results from actions and decisions made by corporate agents. An injured driver may certainly seek compensation from the corporation when a corporate employee negligently causes an accident.[705] The employee driver causing the accident certainly would have violated a duty to the corporate employer in driving negligently, as would directors seeking to entrench management by blocking the votes of certain shareholders. Likewise, when senior corporate management maliciously commits wrongdoing in the course and scope of their duties, that malicious intent is imputed to the corporation.[706] If the law recognizes duties that corporations owe to shareholders arising from

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[702] Under New York law, a corporation does not owe fiduciary duties to its members or shareholders. Hyman v. N.Y. Stock Exch., Inc., 848 N.Y.2d 51, 53 (N.Y. App. Div. 2007). Kansas law does not recognize a fiduciary duty between a corporation and its stockholders. *See* Litton v. Maverick Paper Co., 388 F. Supp. 2d 1261, 1296 (D. Kan. 2005). *Litton* relied on *Burcham v. Unison Bancorp, Inc.*, which holds that it is the directors who owe fiduciary duties to the shareholders, and not the corporation, and that the corporation is not liable for the breach of the directors' fiduciary duties to the shareholders because the directors control the corporation and are therefore not its agents and concludes that it would be unjust to shift responsibility from the directors to the corporation for the directors' breach of duty to shareholders. 77 P.3d 130, 148 (Kan. 2003). Under Alaska law, officers, directors and controlling shareholders owe fiduciary duties to corporation and possibly to shareholders, but corporation does not owe fiduciary duties to its shareholders. *See* Meidinger v. Koniag, Inc., 31 P.3d 77, 87 (Alaska 2001). Under Illinois law, individuals who control corporations owe fiduciary duties to their corporations and their shareholders, but the corporation, as distinct from its officers and directors, does not owe fiduciary duties to shareholders. *See* Small v. Sussman, 713 N.E.2d 1216, 1221 (Ill. App. Ct. 1999); Doherty v. Kahn, 682 N.E.2d 163, 174 (Ill. App. Ct. 1997); Wencordic Enters., Inc. v. Berenson, 511 N.E.2d 907, 918 (Ill. App. Ct. 1987). However, Holmes v. Birtman Elec. Co., 159 N.E.2d 272 (Ill. App. Ct. 1959), *rev'd on other grounds*, 165 N.E.2d 261, 275 (Ill. 1960), held: "In Illinois a corporation and its agents are trustees with respect to the registration of transfers of its securities and are liable for injuries resulting from their failure to discharge such fiduciary responsibilities." *Allmon v. Salem Bldg. & Loan Ass'n* held:

> But a corporation is by law the custodian of the shares of its stock and clothed with power sufficient to protect the rights of everyone interested therein from unauthorized transfers, and, like every other trustee, it is bound to execute the trust with proper diligence and care, and is responsible for an injury sustained by its negligence or misconduct in making transfers or cancellations of such stock.

114 N.E. 170, 172 (Ill. 1916). *Small v. Sussman* distinguishes these cases as limited to situations of transfer of shares. *See Small*, 713 N.E.2d at 1221.

[703] Bennett v. Reynolds, 315 S.W.3d 867, 883 (Tex. 2010) (Corporations, of course, "can act only through human agents.").

[704] *Id.* ("Corporate decisions, likewise, are ultimately made by human agents.").

[705] *In re* Merrill Lynch Trust Co. FSB, 235 S.W.3d 185, 188 (Tex. 2007) ("Corporations can act only through human agents, and many business-related torts can be brought against either a corporation or its employees.").

[706] *Bennett*, 315 S.W.3d at 884 ("Generally, '[w]hen actions are taken by a vice-principal of a corporation, those acts may be deemed to be the acts of the corporation itself,' and 'status as a vice-principal of the corporation is sufficient to impute liability to [the corporation] with regard to his actions taken in the workplace.'"); Hooper v. Pitney Bowes, Inc., 895 S.W.2d 773, 777–78 (Tex. App.—Texarkana 1995, writ denied) ("Generally, the willful and

the legal relationship between a corporation and each of its owners, then the liability falls on the corporation even though officers and directors make the decision to violate such a duty.[707]

Texas case law is abundantly clear that indirect harm suffered by shareholders caused by violations of duties by officers and directors owed solely to the corporation are actionable only by or on behalf of the corporation—that is, the law requires the trustee to recover for the damage done to the trust as a whole so that all the beneficiaries of the trust may be restored proportionately. If an individual shareholder could simply recast every misappropriation of assets by a director as a breach of fiduciary duty to the shareholder by the corporation, then the distinction between the interests of the corporation and the interests of the shareholder would be obliterated. Courts in other jurisdictions have universally condemned attempts to enforce corporate fiduciary duties in this way.[708]

These criticisms are not valid with respect to the corporate duties proposed here. The criticisms are largely a matter of nomenclature. Courts rejecting fiduciary duties imposed on corporations are chiefly concerned about the confusion between those duties that officers and directors owe to the corporation and those duties that a corporation may owe to its shareholders. Courts do not want shareholders to be able to assert a violation of legal duties owed only to the corporation through the back door by claiming that the corporation owes those same duties back to the shareholder. If a shareholder could bring a direct action against

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malicious actions of an employee acting within the scope of his employment are imputed to the employer, and they subject the employer to liability under the principles of *respondeat superior*.").

[707] For example, one recent case reversed an award of attorneys' fees against the individual officers and directors who refused to allow a shareholder to inspect corporation records—causing the corporation to violate the shareholder's statutory inspection rights—holding "section 3.152 contemplates a suit and associated orders against an entity, not against individuals. The fact that the individual defendants may have caused the denial of access and [the corporation] may be affected by the award does not change the statutory language." Tex. Ear Nose & Throat Consultants, P.L.L.C. v. Jones, 470 S.W.3d 67, 90 (Tex. App.—Houston [14th Dist.] 2015, no pet.).

[708] Berkowitz v. 29 Woodmere Blvd. Owners', Inc., 23 N.Y.S.3d 830, 834 (N.Y. App. Div. 2015) ("A corporation does not owe a fiduciary duty to its individual unit owners and shareholders."); *In re* Stillwater Capital Partners Inc. Litig., 851 F. Supp. 2d 556, 569 (S.D.N.Y. 2012) ("Generally, a corporation does not owe fiduciary duties to its members or shareholders, because recognizing such a duty would lead to the confounding possibility that a shareholder of a corporation could bring a derivative action on behalf of the corporation against the corporation itself."); Town of Smyrna v. Mun. Gas Auth., 129 F. Supp. 3d 589, 602 (M.D. Tenn. 2015) ("[C]ourts routinely hold that a corporation owes no fiduciary duty to its shareholders or members."); Bateman v. JAB Wireless, No. 2:14-CV-147-RJS, 2015 WL 4077923, at *4 (D. Utah July 6, 2015) (plaintiffs "directed the court to no Utah or Colorado authority recognizing a fiduciary relationship between a corporation and its shareholders," and other courts, including the Sixth Circuit in Rodol v. Thomas, 772 F.2d 244 (6th Cir. 1985), have considered and rejected the position urged by plaintiffs); *In re* Swisher Hygiene, Inc., No. 3:12-cv-2384, 2015 WL 4132157, at *13 n.4 (W.D.N.C. July 8, 2015) ("[T]he claim against Swisher itself should be dismissed because a corporation does not owe fiduciary duties to its shareholders."); *In re* PHC, Inc. Shareholder Litig., No. Civ. A. 11-11049-GAO, 2012 WL 1195995, at *4 (D. Mass. Mar. 30, 2012) ("As a corporation, PHC itself owes no duty to its shareholders under Massachusetts law"); Onex Food Serv., Inc. v. Grieser, No. 93 Civ. 0278 (DC), 1996 WL 103975, at *7 (S.D.N.Y. Mar. 11, 1996) ("[A] corporation does not owe a fiduciary duty to its shareholders nor may it be held vicariously liable for breaches of fiduciary duty committed by its officers"); Johnston v. Wilbourn, 760 F. Supp. 578, 590 (S.D. Miss. 1991) (same); *Burcham*, 77 P.3d at 146 ("The plaintiffs have not cited any Kansas case in which the court found that a corporation owes a fiduciary duty to its stockholders; rather, it is the corporate management that owes the duty to both the corporation and its stockholders"). *See also* Schupp v. Jump! Info. Techs., 65 F. App'x. 450, 454 (4th Cir. 2003) (citing *Rodol*, 772 F.2d at 258–59) ("[Noting] doubts that a shareholder can maintain an action for breach of fiduciary duty directly against the corporation itself.").

the corporation asserting exactly the same claim that the corporation would assert against its officers and directors, then the corporation's ownership of those claims would be rendered meaningless and the public policy against multiplying litigation, potentially inconsistent results, and denying creditors and other shareholders of the benefits of the corporation's recovery would be thwarted. The corporation would, in effect, have to sue itself. While there may be some overlaps in particular cases, the nature of the duties that the corporation owes to its individual shareholders is different from that of the duties that the officers and directors owe to the corporation. Holding that a corporation does not owe "fiduciary duties" to individual shareholders is not the same as holding that corporations owe no duties to shareholders. Delaware law, for example, does not recognize corporate "fiduciary duties" to shareholders[709] and does not recognize the shareholder oppression cause of action,[710] but Delaware law still holds that corporations have duties of full disclosure to shareholders[711] and provides minority shareholders a direct remedy if they are treated inequitably.[712]

The Texas case law recognizing that the corporation as trustee owes enforceable duties directly to shareholders[713] developed in the same time period as the cases holding that shareholders have no direct recovery for harm done only to the corporation.[714] There is no inconsistency in these two doctrines as applied by Texas courts. The fiduciary duties owed to the corporation and the fiduciary duties owed by the corporation are simply different duties.

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[709] *In re* Wayport, Inc. Litig., 76 A.3d 296, 322–23 (Del. Ch. 2013) ("Wayport is not liable for breach of fiduciary duty. As a corporate entity, Wayport did not owe fiduciary duties to its stockholders."); Arnold v. Soc'y for Sav. Bancorp, Inc., 678 A.2d 533, 539 (Del. 1996) ("Plaintiff has not cited a single case in which Delaware courts have held a corporation directly liable for breach of the fiduciary duty of disclosure. Fiduciary duties are owed by the directors and officers to the corporation and its stockholders.").

[710] *See* Nixon v. Blackwell, 626 A.2d 1366 (Del. 1993).

[711] *See* Malone v. Brincat, 722 A.2d 5, 11–12 n.21 (Del. 1998).

[712] Under Delaware law, the fact that certain measures are lawful under the letter of Delaware's corporate law does not mean that those measures can be deployed for inequitable purposes. *In re* Gaylord Container Corp. Shareholder Litig., 753 A.2d 462, 473 (Del. Ch. 2000); Schnell v. Chris–Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971); Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099, 1106–07 (Del. 1985). Compliance with the governing documents of the corporation does not established the fairness of the transaction. Boyer v. Wilmington Materials, Inc., 754 A.2d 881, 900 (Del. Ch. 1999). Directors have the duty not to time or structure an otherwise legal transaction "so as to permit or facilitate the forced elimination of the minority shareholders at an unfair price." *Id.* at 899; Sealy Mattress Co. v. Sealy, Inc., 532 A.2d 1324, 1335 (Del. Ch. 1987). Directors must make the informed, deliberate judgment in good faith that the transaction is fair and not a "vehicle for economic oppression." *Boyer*, 754 A.2d at 899; *Sealy*, 532 A.2d at 1335. Directors may not, "by way of excessive salaries and other devices, oust the minority of a fair return upon its investment." Michelson v. Duncan, 407 A.2d 211, 217 (Del. 1979). *See also* Accipiter Life Scis. Fund, L.P. v. Helfer, 905 A.2d 115, 124 (Del. Ch. 2006) ("There is, of course, no dispute as to the plaintiff's fundamental point. Delaware corporations may not take actions towards their stockholders which, though legally possible, are inequitable. The source of that standard is *Schnell v. Chris-Craft*, where the Supreme Court held that a board's facially legal use of a bylaw to cut short the time available for stockholders to conduct a proxy contest was inequitable, and thus impermissible. That precedent is a cornerstone of Delaware law, and has repeatedly been reaffirmed by our courts."); Juran v. Bron, No. Civ. A. 16464, 2000 WL 1521478, at *9 (Del. Ch. Oct. 6, 2000) ("Under Delaware law, a majority shareholder of a corporation clearly owes fiduciary duties to the minority shareholders.").

[713] *E.g.,* Yeaman v. Galveston City Co., 167 S.W. 710, 721–22 (Tex. 1914).

[714] *E.g.,* Becker v. Dirs. of Gulf City St. Ry & Real Estate Co., 15 S.W. 1094, 1096 (Tex.1891).

### *3. Limited Scope of the Corporate Duties*

Conceptualizing the corporation as trustee for its shareholders does have some limitations. None of the courts recognizing this legal relationship hold that there is a one-to-one correspondence to an express trust—rather the cases hold that the relationship is "akin to one of trust."[715] The principal economic feature of the corporation is the separation of ownership from control.[716] A corporation is like a trust in that the corporation owns legal title to its assets and business operations, while the shareholders hold equitable ownership.[717] In that sense, the corporation is like a trustee, and the shareholders are like the beneficiaries of the trust. [718] However, there is an additional aspect of the corporate structure that is unlike a trust. While the corporation holds legal title, it can do nothing apart from its agents.[719] Control over the assets and operation of the corporation is vested in the directors and officers.[720] A human trustee holds both legal title and exercises control.[721] A corporation only holds legal title; its officers and directors exercise control. The management of the corporation owes fiduciary duties to the corporation or shareholders collectively, not to the shareholders individually.[722] These are the duties that arise out of the exercise of control—duties that are based in the law of agency.[723]

Trustees are held to a strict duty not to misappropriate trust property for their own benefit.[724] However, a corporation cannot possess property outside of itself; therefore, it would be impossible for a corporation to possess corporate property in which the shareholders would not still own a beneficial interest. Trustees are required to place the interests of the beneficiaries before their own interests.[725] However, a corporation has no self-interest that is

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[715] Disco Mach. of Liberal Co. v. Payton, 900 S.W.2d 124, 126 (Tex. App.—Amarillo 1995, writ denied).

[716] *See* PHC-Minden, LP v. Kimberly-Clark Corp., 235 S.W.3d 163, 174–75 (Tex. 2007).

[717] Roadside Stations, Inc. v. 7HBF, Ltd., 904 S.W.2d 927, 931 (Tex. App.—Fort Worth 1995, no writ); Rapp v. Felsenthal, 628 S.W.2d 258, 260 (Tex. App.—Fort Worth 1982, writ ref'd n.r.e.).

[718] "[I]t is well established that the legal and equitable estates must be separated; the former being vested in the trustee and the latter in the beneficiary. This separation of the legal and equitable estates in the trust property is the basic hallmark of the trust entity." Perfect Union Lodge No. 10 v. Interfirst Bank of San Antonio, N.A., 748 S.W.2d 218, 220 (Tex. 1988) (citing Cutrer v. Cutrer, 334 S.W.2d 599, 605 (Tex. Civ. App.—San Antonio), *aff'd*, 345 S.W.2d 513 (Tex. 1961)); Miller v. Donald, 235 S.W.2d 201, 205 (Tex. Civ. App.—Fort Worth 1950, writ ref'd n.r.e.); George G. Bogert, TRUSTS & TRUSTEES § 141, at 4 (2d ed. 1979)). *See also* Burns v. Miller, Hiersche, Martens & Hayward, P.C., 948 S.W.2d 317, 322 (Tex. App.—Dallas 1997, writ denied) ("The trustee of a trust holds bare legal title and the right to possession of trust assets, while the beneficiary is considered the real owner of the property, holding equitable or beneficial title.").

[719] *Rapp*, 628 S.W.2d at 260.

[720] TEX. BUS. ORGS. CODE ANN. §§ 3.101, 21.401, 21.402 (West 2011).

[721] S. Pac. Co. v. Bogert, 250 U.S. 483, 487–88 (1919) ("The rule of corporation law and of equity invoked is well settled and has been often applied. The majority has the right to control; but when it does so, it occupies a fiduciary relation toward the minority, as much so as the corporation itself or its officers and directors."); Dierschke v. Ctr. Nat'l Branch of First Nat'l Bank at Lubbock, 876 S.W.2d 377, 381 (Tex. App.—Austin 1994, no writ).

[722] *Rapp*, 628 S.W.2d at 260.

[723] Evans v. Brandon, 53 Tex. 56, 60 (1880) ("On principle and authority, it is clear that the liability of directors for a breach of duty that injures the corporate property as a whole, is primarily to the corporation whose agents they are."). *See also* RESTATEMENT (SECOND) OF TRUSTS § 16A cmt. a (1959) ("The officers and directors of a corporation do not hold the title to the property of the corporation and therefore are not trustees.").

[724] Ames v. Ames, 757 S.W.2d 468, 476 (Tex. App.—Beaumont 1988), *aff'd*, 776 S.W.2d 154 (Tex. 1989).

[725] *Id.*

not shared by all the shareholders.

The legal duties that the corporation as an entity owes directly to each of its shareholders, whether or not characterized as "fiduciary" duties, are "narrow."[726] Nevertheless, there are still distinct and important duties that the corporation owes to the shareholders. These duties arise out of legal ownership for the benefit of someone else—the same kinds of duties that the trustee owes to the beneficiary of the trust by virtue of the separation of legal and equitable title.[727] The duties described in *Yeaman* deal only with the impairment of individual shareholders' rights and interests as shareholders. The corporation breaches those duties if it denies that the shareholder is an owner or withholds the shareholder's proportional share of profits or otherwise acts to impair the shareholder's fundamental property rights. The corporation also breaches these duties when it fails to act impartially and neutrally among its shareholders. Impartiality is a matter of intent.[728] A corporation is impartial when it is fair to all and does not act with the intent to favor one and disadvantage another.[729] Absolute equality in results and effects is not required.[730]

Therefore, the duties that a corporation, as trustee, owes to its shareholders, as beneficiaries to the trust, are not far-reaching and vague obligations always to place the interests of each individual shareholder before its own,[731] and certainly not the duty rejected in *Ritchie* to "act in the best interests of each individual shareholder at the expense of the corporation."[732] Rather, the corporation's trust duties would be limited to the observance and preservation of each individual shareholder's recognized property rights and to dealing with its multiple owners according to its duty of impartiality. Returning to the subject of "gaps" in the protection of minority shareholders, corporate actions would certainly violate duties owed directly to each minority shareholder—duties recognized by the Texas Supreme Court in the *Yeaman* opinion—if those actions impaired the rights and benefits of share ownership or were aimed at either driving the shareholder out of the company at an economic loss or rendering the shareholder effectively not a shareholder. Similarly, corporate action, such as not declaring

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726 *See* Reibe v. Nat'l Loan Inv'rs, 828 F. Supp. 453, 456 (N.D. Tex. 1993).

727 Dierschke v. Ctr. Nat'l Branch of First Nat'l Bank, 876 S.W.2d 377, 381 (Tex. App.—Austin 1994, no writ) ("A trustee holds legal title to trust property under a fiduciary duty to deal with it for the benefit of the beneficiaries, who hold equitable title."); Jameson v. Bain, 693 S.W.2d 676, 680 (Tex. App.—San Antonio 1985, no writ) ("[T]he trustee is vested with the legal title and the right of possession of the trust property, but holds it for the benefit of the beneficiary.").

728 *See, e.g.*, N. Trust Co. v. Heuer, 560 N.E.2d 961, 964 (Ill. App. Ct. 1990) ("Unless terms of trust document provide otherwise, trustee's fiduciary duty to each beneficiary precludes her from favoring one beneficiary over another.").

729 RESTATEMENT (THIRD) OF TRUSTS § 79 at 129 (2007) ("Impartiality . . . means that a trustee's treatment of beneficiaries or conduct in administering a trust is not to be influenced by the trustee's personal favoritism or animosity toward individual beneficiaries.").

730 "It would be overly simplistic, and therefore misleading, to equate impartiality with some concept of 'equality' of treatment or concern—that is, to assume that the interests of all beneficiaries have the same priority and are entitled to the same weight in the trustee's balancing of those interests." RESTATEMENT (THIRD) OF TRUSTS § 79 cmt. b. *See also* UNIF. TRUST CODE § 803 cmt. ("The duty to act impartially does not mean that the trustee must treat the beneficiaries equally. Rather, the trustee must treat the beneficiaries equitably in light of the purposes and terms of the trust.").

731 *E.g.*, Crim Truck & Tractor Co. v. Navistar Int'l Transp. Corp., 823 S.W.2d 591, 594 (Tex. 1992).

732 Ritchie v. Rupe, 443 S.W.3d 856, 888 (Tex. 2014).

dividends, taken with the specific intent to harm minority shareholders, would certainly constitute an actionable "breach of trust."[733] As developed below, the legal duties described here are enforced through a cause of action that we will call "breach of trust" to avoid confusion with "breach of fiduciary duties" that directors owe to the corporation.

## VII. DEFINING THE BREACH OF TRUST CAUSE OF ACTION

As discussed above, individual shareholders have ownership rights and interests that are important, protected, and distinct from the rights and interests of the corporation or of the shareholders collectively. As the Texas Supreme Court held in *Cates v. Sparkman*, an individual shareholder's claim for relief must be based on conduct that is "ultra vires, fraudulent, [or constitutes] 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 [an equitable remedy], would leave the latter remediless."[734] Therefore, individual shareholders may assert direct claims for their own benefit to vindicate and enforce these individual rights and interests against violations by the corporation in three instances: (1) ultra vires, (2) fraud, and (3) "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 [an equitable remedy], would leave the latter remediless." The first two categories are straight-forward and uncontroversial and will be explored later. The third category, however, specifically deals with the "gaps" left by the *Ritchie* Court's holding.

### A. Corporate Acts of Oppression

*Cates v. Sparkman* used the terms "injurious practices, abuse of power, and oppression" to describe the type of corporate acts that would give rise to a cause of action by an individual shareholder.[735] The Fort Worth Court of Appeals, in a case decided the same year as *Yeaman*, described the plight of minority shareholders as follows:

> It cannot be denied that minority stockholders are bound hand and foot to the majority in all matters of legitimate administration of the corporate affairs, and the courts are powerless to redress many forms of oppression practiced upon the minority under the guise of legal sanction, which fall short of actual fraud. This is a consequence of the implied contract of association, by which it is agreed, in advance, that a majority shall bind the whole body as to all transactions within the scope of the corporate powers. But it is also of the essence of the contract that the corporate powers shall only be exercised to accomplish the objects for which they were called into existence, and that the majority shall not control those powers to pervert or destroy the original purposes of the corporators.[736]

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[733] Patton v. Nicholas, 279 S.W.2d 848 (Tex. 1955); Morrison v. St. Anthony Hotel, 295 S.W.2d 246, 252 (Tex. Civ. App.—San Antonio 1956, writ ref'd n.r.e.).

[734] Cates v. Sparkman, 11 S.W. 846, 849 (Tex. 1889).

[735] *Id.*

[736] Tipton v. Ry. Postal Clerks' Inv. Ass'n, 173 S.W. 562, 567 (Tex. Civ. App.—Fort Worth 1914, no writ).

The concept that minority shareholders may be subject to "oppression" is one that has been recognized in Texas law for a long time. However, defining what constitutes "oppression" with precision remains a challenge. *Cates* describes the first element of an individual shareholder cause of action as an intentional breach of duty by the corporations using the terms "injurious practices, abuse of power, and oppression on the part of the company or its controlling agency."[737] As the *Ritchie* Court noted in working through the statutory definition of "oppressive," the "common meaning and usage" of the term oppression involves "an unjust exercise of power that harms the rights or interests of persons subject to the actor's authority and disserves the purpose for which the power is authorized."[738] This definition of "oppression" is also very consistent with the other two descriptive phrases used by *Cates*, "injurious practices" and "abuse of power." Therefore, the first element must involve an intentional use of the corporation's powers over its shareholders in violation of the duties owed by the corporation to its shareholders. Intentional efforts to harm minority interests, such as the conduct in *Patton* and *Morrison* to deny the minority shareholders the economic benefits of share ownership by suppressing dividends, would violate the corporation's duties to recognize and preserve the interests of the shareholders in their stock and its fruits and would also violate the duty of impartiality. Both *Patton* and *Morrison* involved dividend decisions that are ordinarily accorded maximum deference by the courts and would seem to fall within that range of activities that *Cates* held the directors of the corporation "have the right to do" and which cannot form the basis of a shareholder action. However, neither *Patton* nor *Morrison* even considered that issue, focusing instead on the "malicious" purpose of the conduct. Therefore, the only possible conclusion is that corporate action taken with the intent to specifically harm the interests of a minority shareholder constitutes a breach of duty that gives rise to a claim. Actions taken with such intent are categorically not something that corporations have the "right to do."

### B. Elements of Breach of Trust

As stated in *Cates v. Sparkman*, equitable relief is available in an action brought directly by the minority shareholder against the corporation to remedy a broad category of wrongful corporate conduct defined as follows: (1) "injurious practices, abuse of power, and oppression on the part of the company or its controlling agency," (2) "clearly subversive of the rights of the minority, or of a shareholder," and (3) "without such [an equitable remedy], would leave the latter remediless."[739]

#### *1. Intent to Harm the Minority*

A plaintiff asserting a breach of trust claim would be required, first, to prove corporate action with the intent to harm or disadvantage the minority, conduct that *Cates* characterized as "injurious practices, abuse of power, and oppression on the part of the company or its controlling agency."[740] The controlling fact in the cause of action recognized in *Patton* was the "malicious purpose" or "wrongful state of mind" in connection with the corporate decision not

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737 *Cates*, 11 S.W. at 849.

738 *Ritchie*, 443 S.W.3d at 870.

739 *Cates*, 11 S.W. at 849.

740 *Id.*

to declare dividends.[741] It would not seem necessary to prove common law malice, defined as "ill-will, spite, or evil motive."[742] Rather, what is at issue is the violation of the corporation's duty of impartiality, which would require proof of an intention to harm the interests of the minority or to favor the interests of the majority at the expense of the minority.[743] However, proof that the decision was influenced by personal animosity against or hostile relations with the minority would certainly be relevant.[744]

In extreme cases, like *Boehringer* and *Davis*, where a majority shareholder causes a corporation to functionally cancel a minority shareholder's ownership interest, there should be little question that the minority shareholder has an individual claim. Less extreme cases, however, such as the underlying dispute in *Ritchie*, are more difficult. In a lawsuit like *Ritchie*, the plaintiff would likely allege that the corporate policy not to meet with potential purchasers was a violation of the duty of impartiality because only the plaintiff was trying to sell her shares, and only she was disadvantaged by the effect of the policy. That allegation, however, would not state a claim for breach of the duty of impartiality. The policy did affect all shareholders the same. Under the particular circumstances, its negative effects were felt more by one shareholder than others, but none of the shareholders were benefitted at the expense of any other shareholder. The plaintiff might be able to establish entitlement to an equitable remedy, but only if the plaintiff could prove that the corporate "policy" was a pretext and that the true purpose and intent had been a desire to harm the single shareholder.

### *2. Impairment of Minority Ownership Rights*

The plaintiff would also need to establish that the corporation's failure to treat him impartially also impaired[745] recognized ownership rights, such as the rights of recognition of ownership, voice, information, alienation, or proportional share in profits—in other words, that the oppressive conduct was "clearly subversive of the rights of the minority, or of a shareholder."[746]

### *3. No Adequate Alternative Remedy*

Finally, in order to invoke the remedial powers of a court in equity, the plaintiff must prove the absence of an adequate alternative remedy—that "without such [an equitable remedy], would leave the latter remediless."[747] "The existence of an adequate remedy at law" bars equitable relief.[748] Therefore, if the plaintiff can be made whole through application of a

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[741] Patton v. Nicholas, 279 S.W.2d 848, 853 (Tex. 1955).

[742] Huckabee v. Time Warner Enter. Co. L.P., 19 S.W.3d 413, 420 (Tex. 2000).

[743] RESTATEMENT (THIRD) OF TRUSTS § 79 at 129 (2007) ("Impartiality means that a trustee's treatment of beneficiaries or conduct in administering a trust is not to be influenced by the trustee's personal favoritism or animosity toward individual beneficiaries.").

[744] *See In re* Estate of Stuchlik, 857 N.W.2d 57, 70 (Neb. 2014); Reed v. Ringsby, 54 N.W.2d 318, 322 (Neb. 1952).

[745] *Yeaman*, 167 S.W. at 723.

[746] Cates v. Sparkman, 11 S.W. 846, 849 (Tex. 1889).

[747] *Id.*

[748] Butnaru v. Ford Motor Co., 84 S.W.3d 198, 210 (Tex. 2002); Campbell v. Wilder, 487 S.W.3d 146, 152 (Tex. 2016).

statutory or legal remedy, such as recovery of damages through a derivative suit or the enforcement of statutory inspection rights, equity will not provide an additional remedy. The equitable remedies are available only in the absence of an adequate remedy at law.[749] It is the plaintiff's burden to plead and prove that there is no adequate remedy at law.[750]

"The fact that the "complainant may have a remedy at law," however, "is not conclusive that such remedy is adequate and does not foreclose his right to equitable relief."[751] The legal remedy must be "complete and adequate."[752] Equitable relief will be available when "the legal remedy is not as complete as, less effective than, or less satisfactory than the equitable remedy."[753] In *Davis v. Sheerin*, the court recognized that damages awarded in a derivative suit would make the plaintiff whole for some of the wrongdoing, but would not remedy the total exclusion and disregard of the plaintiff's ownership interest and would not remedy the pattern of oppression and likelihood of its continuation.[754] In determining the completeness and adequacy of legal remedies, courts should determine whether those in control of the corporation are acting for the purpose of harming the minority shareholder and the likelihood that they will continue to do so, as the Supreme Court did in *Patton*.[755]

An important corollary is that "[e]quity looks with favor upon a complete disposition of controversies in one action rather than in multiple suits. Equity abhors a multiplicity of actions."[756] If the only prospect the minority shareholder has to protect his rights is a never-ending series of derivative damages claims and statutory enforcement actions, the court of equity would step in to provide a more permanent remedy.

> If equity jurisdiction can interfere to prevent a multiplicity of suits, the condition of this record presents such facts or conditions as to call for the exercise thereof. It would be a paradox to say that equity jurisdiction can be exercised to prevent a multiplicity of suits and at the same time say that a legal remedy is complete and adequate, although it leads to such multiplicity. To our minds, if a remedy at law, though otherwise complete and adequate, leads to a multiplicity of suits, that very fact prevents it from being complete and adequate.[757]

In a typical shareholder oppression lawsuit involving firing the plaintiff, no dividends, and

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[749] Salgo v. Matthews, 497 S.W.2d 620, 625 (Tex. Civ. App.—Dallas 1973, writ ref'd n.r.e.); *see also* Callahan v. Giles, 155 S.W.2d 793, 795 (Tex. 1941) (mandamus governed by equitable principles); Poten v. Lockhart, 114 S.W.2d 219, 220 (Tex. 1938).

[750] Davis v. Estridge, 85 S.W.3d 308, 310 n.2 (Tex. App.—Tyler 2001, pet. denied); Frost Nat'l Bank v. Burge, 29 S.W.3d 580, 596 (Tex. App.—Houston [14th Dist.] 2000, no pet.).

[751] Repka v. Am. Nat'l Ins. Co., 186 S.W.2d 977, 980 (Tex. 1945).

[752] Rogers v. Daniel Oil & Royalty Co., 110 S.W.2d 891, 894 (1937).

[753] First Heights Bank, FSB v. Gutierrez, 852 S.W.2d 596, 605 (Tex. App.—Corpus Christi 1993, writ denied). *See Frost Nat'l Bank*, 29 S.W.3d at 596.

[754] Davis v. Sheerin, 754 S.W.2d 375, 384 (Tex. App.—Houston [1st Dist.] 1988, writ denied), *disapproved by*, Ritchie v. Rupe, 443 S.W.3d 856 (Tex. 2014).

[755] Patton v. Nicholas, 279 S.W.2d 848, 857 (Tex. 1955) ("Wisdom would seem to counsel tailoring the remedy to fit the particular case.").

[756] Barr v. Thompson, 350 S.W.2d 36, 42 (Tex. Civ. App.—Dallas 1961, no writ).

[757] Repka v. Am. Nat'l Ins. Co., 186 S.W.2d 977, 980 (Tex. 1945) (quoting *Rogers*, 110 S.W.2d at 896).

excessive compensation to the majority shareholder, the plaintiff's claim would involve conduct that potentially breached both officer/director duties to the corporation and corporate duties to the minority shareholder. Under *Ritchie*, the plaintiff could assert derivative claims to recover the overpayments to the majority shareholder as damages and for injunctive relief to compel payment of dividends. Depending on the case, those remedies might be adequate to make the plaintiff whole, in which case the plaintiff would have no equitable remedy for the violation of the corporation's duties to himself. However, in most cases where a court would have granted a remedy under the shareholder oppression doctrine, the plaintiff would be able to argue that his legal remedies described by the *Ritchie* Court[758] are inadequate because they provide no remedy that would fully compensate the minority shareholder for the harm caused by the impairment of his ownership rights, provide no protection against the majority shareholder's malicious intent to harm the minority and the likelihood of future repetition, and will necessarily lead to a multiplicity of actions.

## C. Remedies for Breach of Trust

### *1. Mandatory Injunctions*

In *Yeaman*, the Texas Supreme Court held that the plaintiffs were entitled to bring a breach of trust claim to "to enforce their rights as stockholders"[759]—specifically to obtain a determination of how many shares the plaintiffs owned and, presumably, a mandatory injunction to have the certificates issued. Under Texas law, a shareholder is entitled to equitable relief compelling the corporation to acknowledge the shareholder's ownership and to issue share certificates in his name.[760] The plaintiff "may sue in equity for specific performance to enforce the issue and delivery of the stock certificate and the payment of any dividends that may be due thereon, or he may, as plaintiffs have here done here, sue to recover the consideration paid for the stock."[761] However, a shareholder's rights entail more than just the right to hold a certificate, and the corporation's duties extend to "not attempting to impair his interest."[762]

A court of equity has extremely broad powers to remedy a breach of trust.[763] Courts have the power to intervene in an "abuse of discretion" by trustees "and adjust the rights of the parties and to compel, if necessary, action on the part of the trustees."[764] Therefore, a court of

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[758] *Ritchie,* 443 S.W.3d at 882–89.

[759] Yeaman v. Galveston City Co., 167 S.W. 710, 723 (Tex. 1914).

[760] TEX. PRAC.: BUS. ORGS., *supra* note 7, at § 27:29; *see* Lilani v. Noorali, No. H-09-2617, 2011 WL 13667, at *15 (S.D. Tex. Jan. 3, 2011) (Texas law).

[761] Beaumont Hotel Co. v. Caswell, 14 S.W.2d 292, 294 (Tex. Civ. App.—Beaumont 1929, no writ); *see also* Mathews v. First Citizens Bank, 374 S.W.2d 794, 796–97 (Tex. Civ. App.—Dallas 1963, writ ref'd n.r.e.) ("[H]e may seek equitable relief against the wrongdoer to compel it to replace the shares of stock on its books in his name.").

[762] *Yeaman*, 167 S.W. at 723.

[763] *See, e.g.*, TEX. PROP. CODE ANN. § 114.008 (West 2015) (providing that courts may compel the trustee to perform the trustee's duty or duties, enjoin the trustee from committing a breach of trust, compel the trustee to redress a breach of trust, including compelling the trustee to pay money or to restore property, order a trustee to account, appoint a receiver to take possession of the trust property and administer the trust, or order any other appropriate relief).

[764] Kelly v. Womack, 268 S.W.2d 903, 907 (Tex. 1954). *See also* Citizens & S. Nat'l Bank v. Haskins, 327 S.E.2d 192, 202 (Ga. 1985) ("The court may also interpose its judgment when a trustee is acting from improper

equity would be empowered to fashion appropriate remedies to deal with specific violations of shareholder rights.[765] "Certainly the rule allowing such equitable remedies to protect relationships of trust encompasses the ability to fashion such remedies against those who would conspire to abuse such relationships."[766] One example of such a remedy would be a mandatory injunction of the kind ordered by the Supreme Court in *Patton v. Nicholas* to remedy a wrong "akin to breach of trust."[767]

"Equity will not suffer a right to be without a remedy."[768] The United States Supreme Court observed:

> That the vast and increasing proportion of the active business of modern life which is done by corporations should call into exercise the beneficent powers and flexible methods of courts of equity, is neither to be wondered at nor regretted; and this is especially true of controversies growing out of the relations between the stockholder and the corporation of which he is a member. The exercise of this power in protecting the stockholder against the frauds of the governing body of directors or trustees, and in preventing their exercise, in the name of the corporation, of powers which are outside of their charters or articles of association, has been frequent, and is most beneficial, and is undisputed. These are real contests, however, between the stockholder and the corporation of which he is a member.[769]

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motives in exercising discretion."); Simpson v. Anderson, 137 S.E.2d 638 (Ga. 1964) ("the relief granted by a court of equity in dealing with trust estates will always be so moulded and framed as to render the trust effectual and secure the best interest of all parties.").

[765] *See, e.g., Kelly*, 268 S.W.2d at 907 ("Should the trustees be derelict in their duty and be guilty of abuse of discretion or of not moving with reasonable diligence, the beneficiaries would have resort to the court to determine and adjust the rights of the parties and to compel, if necessary, action on the part of the trustees."); Powell v. Parks, 86 S.W.2d 725, 727 (Tex. 1935) ("Inasmuch as the existence of the trust here involved is cognizable by the trial court as a court of general equity jurisdiction, all matters pertaining to the execution of such trust is subject to that jurisdiction."); Dernick Res., Inc. v. Wilstein, 471 S.W.3d 468, 482 (Tex. App.—Houston [1st Dist.] 2015, pet. filed) ("Courts may fashion equitable remedies such as profit disgorgement and fee forfeiture to remedy a breach of a fiduciary duty."); Kauffman v. Parker, 99 S.W.2d 1074, 1079 (Tex. Civ. App.—Fort Worth 1936, no writ) ("[I]t is well settled that a court of equity has jurisdiction to accord relief to the beneficiary of a trust for misuse of trust funds and for betrayal of the trust in any other manner."); Greater Fort Worth v. Mims, 574 S.W.2d 870, 872 (Tex. Civ. App.—Fort Worth 1978, writ dism'd w.o.j.) ("The essence of equity jurisdiction has been the power of the Chancellor to do equity and to mold each decree to the necessities of the particular case. Flexibility rather than rigidity has distinguished it.").

[766] ERI Consulting Eng'rs, Inc. v. Swinnea, 318 S.W.3d 867, 881 (Tex. 2010).

[767] Patton v. Nicholas, 279 S.W.2d 848, 857–58 (Tex. 1955).

[768] Chandler v. Welborn, 294 S.W.2d 801, 807 (Tex. 1956). *See also* Christus Health Se. Tex. v. Griffin, 175 S.W.3d 548, 552 (Tex. App.—Beaumont 2005, pet. denied) ("It is axiomatic that equity will not suffer a right to exist with a remedy.").

[769] Hawes v. City of Oakland, 104 U.S. 450, 453 (1881). This landmark United States Supreme Court case distinguished between suits brought individually by a shareholder against the corporation to enforce his own rights in a court of equity, which the Court characterizes as "frequent, and [] most beneficial," from derivative suits in which the shareholder brings suit on behalf of the corporation "in which the rights involved are those of the corporation, and the controversy is one really between that corporation and the other party." *Id.* at 454. This case has been repeatedly cited by Texas courts as controlling authority. *E.g.*, Zauber v. Murray Sav. Ass'n, 591 S.W.2d 932, 937 (Tex. Civ. App.—Dallas 1979, writ ref'd); Rex Ref. Co. v. Morris, 72 S.W.2d 687, 691–92 (Tex. Civ. App.—Dallas 1934, no writ); Gibbons Mfg. Co. v. Milan, 17 S.W.2d 844, 846 (Tex. Civ. App.—Texarkana 1929, no writ).

Through the use of injunctive relief, courts may remedy specific instances of oppressive conduct. In fashioning the remedy, courts have the inherent power of "tailoring the remedy to fit the particular case,"[770] taking due regard of "the malicious character of the misconduct heretofore involved and the consequent possibility of its repetition."[771]

### *2. Damages*

Actual damages are recoverable for breach of fiduciary duties.[772] The court in *Morrison v. St. Anthony Hotel* held that the plaintiff, a former minority shareholder, could recover damages sustained while he was still a shareholder based on a "breach of trust theory."[773] Specifically, the plaintiff was entitled to recover the amounts which should have been declared as dividends based on the net earnings actually achieved and amount that would have been available for distribution but for the misconduct of the corporation and its majority shareholder who "maliciously mismanaged the corporation for the wrongful purpose of reducing the minority's earnings and to suppress their dividends."[774]

### *3. Rescission and Restitution*

Injunctions and damages may remedy or curb particular abuses, but they leave the minority shareholder trapped in the closely-held corporation subject to continued abuse by the majority. Courts might order rescission of the plaintiff's investment and restitution of the consideration paid as a way of freeing the minority shareholder and effectively remedying a pattern of oppression if it is possible to restore the status quo ante.[775] The Fort Worth Court of Appeals affirmed this approach in *Duncan v. Lichtenberger*.[776] That case was decided four years before *Davis v. Sheerin* and did not apply the shareholder oppression doctrine as the basis for its holding. The case was not brought as a derivative action but was characterized by the court as "a suit grounded in equity where [the minority shareholders] sought damages for a breach of fiduciary duty owed by [majority shareholder], Waldron W. Duncan, to them."[777] In *Duncan*, the parties were partners in a general partnership that ran a club. In June of 1978, the parties formed a corporation and transferred the assets of the original partnership and an additional $10,000 from each of them.[778] Following the purchase of two of the other shareholder's interests, Duncan became the 60% majority shareholder, with the two plaintiffs at 20% each. On October 31, 1978, both plaintiffs found themselves locked out of the club, and Duncan informed them that they were both fired.[779] Duncan failed to give the plaintiffs notice

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[770] *Patton*, 279 S.W.2d at 857.

[771] *Id.* at 858.

[772] *See* Kahn v. Seely, 980 S.W.2d 794, 799 (Tex. App.—San Antonio 1998, pet. denied); Capital Title Co. v. Donaldson, 739 S.W.2d 384, 391 (Tex. App.—Houston [1st Dist.] 1987, no writ).

[773] 295 S.W.2d 246, 252 (Tex. Civ. App.—San Antonio 1956, writ ref'd n.r.e.).

[774] *Id.*

[775] Neese v. Lyon, 479 S.W.3d 368, 381 (Tex. App.—Dallas 2015, no pet.) ("To summarize, then, rescission is generally limited to cases in which counter-restitution by the claimant—that is, the return to the defendant of whatever the claimant received in the transaction—will restore the defendant to the status quo ante.").

[776] 671 S.W.2d 948 (Tex. App.—Fort Worth 1984, writ ref'd n.r.e.).

[777] *Id.* at 949.

[778] *Id.* at 950.

[779] *Id.* at 951.

of director and shareholder meetings, which he alone attended, paid himself management fees and officer compensation, and accumulated earnings in the corporation while withholding dividends (thereby imposing tax liability on the plaintiffs).[780] There was also evidence that the defendant spoke openly about his admiration for two businessmen who were able to squeeze out their business partners.[781] The jury found in favor of the plaintiffs on breach of fiduciary duty. The trial court rendered a judgment restoring to the plaintiffs the cash they paid and their share of the assets contributed at the time of incorporation.[782] The court of appeals affirmed.

With respect to the liability issues, *Duncan v. Lichtenberger* was clearly wrong. The court based the judgment on the assumption that the majority shareholder owed fiduciary duties to the minority shareholders, while citing cases that clearly dealt with the duties that directors owe the corporation.[783] In light of the *Ritchie* opinion, *Duncan* should have been brought as a derivative action, in which case it is questionable whether the equitable relief of rescission and restitution could have been granted in favor of the individual minority shareholders, although as noted above that result is a possibility in light of *Ritchie*'s interpretation of *Patton*. However, *Duncan* most certainly could have been brought as a claim for breach of trust. Every instance of wrongdoing was a corporate action taken with the intent of disadvantaging the minority and which certainly impaired their rights of voice and proportionate share in the profits. As a breach of trust case, rescission and restitution would most certainly have been an equitable remedy available.[784] The *Duncan* court noted: "It has commonly been recognized by the courts that equitable relief is available for a breach of fiduciary duty."[785] The court also discussed the *Patton* case, noting that the *Patton* Court had held that a "wrong akin to breach of trust, for which the courts will afford a remedy"[786] and noted that the only difference between *Patton* and "the present case is the form of relief prayed for."[787]

### *4. Buy-Out*

Rescission and restitution worked in *Duncan* because the oppressive conduct occurred very shortly after the investment. In most cases of oppression, however, that remedy not only would not work, but would be manifestly unjust. Most closely-held corporations are started with nominal consideration. Returning that consideration and allowing the majority shareholder to keep the full benefit of the years spent building the corporation ordinarily would not remedy oppression but would constitute a judicially-sanctioned squeeze-out of the minority.

In most cases of oppression, where the plaintiff is at the mercy of a majority that has and will continue to utilize the corporation to impair and destroy all benefit of share ownership to the minority, the only adequate remedy is to require the purchase of the plaintiff's shares for

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780 *Id.*

781 *Id.* at 951–52.

782 *Id.* at 952.

783 *See id.* (citing Canion v. Tex. Cycle Supply, Inc., 537 S.W.2d 510, 513 (Tex. Civ. App.—Austin 1976, writ ref'd n.r.e.), and Int'l Bankers Life Ins. Co. v. Holloway, 368 S.W.2d 567 (Tex. 1963)).

784 Miller v. Miller, 700 S.W.2d 941, 948 (Tex. App.—Dallas 1985, writ ref'd n.r.e.).

785 671 S.W.2d at 952.

786 *Id.* at 953 (quoting Patton v. Nicholas, 279 S.W.2d 848, 854 (Tex. 1955)).

787 *Id.*

their fair value. As the court held in *Davis v. Sheerin*, "Texas courts, under their general equity power, may decree a 'buy-out' [] where less harsh remedies are inadequate to protect the rights of the parties."[788] While the Texas Supreme Court in *Ritchie* held that the buy-out remedy was not available under the receivership statute and that there was no stand-alone shareholder oppression cause of action in the common law, the Court did not hold that a buy-out order was not available as an equitable remedy for other causes of action. Nothing in the *Ritchie* opinion questions the equitable power to order a buy-out as stated in *Davis*. On the contrary, the *Ritchie* Court expressly suggested that the remedy might be available for breach of an informal fiduciary duty between shareholders arising from a relationship of trust and confidence,[789] and did not foreclose a buy-out order as part of a receiver's rehabilitation of a corporation.[790]

Nevertheless, a compulsory buy-out is an extreme remedy. The *Ritchie* Court questioned the dissent's assumption that a court-ordered buy-out was always a "lesser remedy" than appointment of a rehabilitative receiver, noting that the remedy had been criticized by some commentators as sometimes threatening the financial security of closely-held corporations, even pushing them into bankruptcy or dissolution.[791] The buy-out remedy should only be available in very serious cases where the remedy is truly justified and where lesser remedies are insufficient. Two types of situations would seem most appropriate for a compulsory buy-out. First, when the corporation, not only impairs the shareholder's interests but actually attempts to extinguish them, a buy-out would seem the only appropriate remedy. A corporation's refusal to acknowledge a shareholder's ownership or denial that one is a shareholder is a violation of the shareholder's property rights and of the corporation's duties as trustee. As the Supreme Court in *Yeaman* noted, a corporation is absolutely prohibited from any attempt to forfeit the ownership interests of a stockholder.[792] In *Rio Grande Cattle Co. v. Burns*[793], the Texas Supreme Court held that a corporation's refusal to recognize the ownership interest of a shareholder constituted the tort of conversion and entitled the shareholder to either compel the formal issuance of share certificates or to receive in assumpsit the value of what was taken, the fair market value of his shares.[794] This is the functional equivalent of an equitable buy-out order.[795] In *Davis v. Sheerin*, the majority shareholder denied that the plaintiff was a shareholder and was found by the jury to have conspired to deprive the plaintiff of his ownership in the corporation. This conduct, the court held, would "totally extinguish" all rights and expectations of share ownership and justified a court-ordered buy-out.[796] Had the case been tried as a breach of trust case, the result should have been the same.

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[788] Davis v. Sheerin, 754 S.W.2d 375, 380 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

[789] Ritchie v. Rupe, 443 S.W.3d 856, 891–92 (Tex. 2014).

[790] *Id.* at 874–76.

[791] *Id.* at 875 n.26.

[792] Yeaman v. Galveston City Co., 167 S.W. 710, 723 (Tex. 1914) ("We are unwilling to affirm that, in the absence of some statutory or charter power, or express consent to that effect, a corporation has any authority to forfeit a stockholder's shares upon such a ground. It is a trustee for the interests of its shareholders in its property, and is under the obligation to observe its trust for their benefit.").

[793] 17 S.W. 1043 (Tex. 1891).

[794] *Id.* at 1046.

[795] We will explore the tort of stock conversion as an independent remedy that fills in some of the gaps left by *Ritchie* in Part 2 of this article.

[796] Davis v. Sheerin, 754 S.W.2d 375, 382 (Tex. App.—Houston [1st Dist.] 1988, writ denied), *disapproved by*, Ritchie v. Rupe, 443 S.W.3d 856 (Tex. 2014).

The other situation which should warrant the remedy of a buy-out is when the corporation admits that the plaintiff is a shareholder but conducts its activities so as to eliminate his share ownership as a practical matter by systematically ignoring his property rights and violating its duties to preserve them—no voice, no information, no share in corporate profits. These kinds of corporate actions fundamentally change the nature of the minority shareholder's investment. In Texas common-law, the buy-out remedy was available in ultra vires cases in which the corporation caused such a fundamental change in the nature of the investment. In cases decided prior to the passage of statutes governing corporate mergers and providing rights of dissent and appraisal remedies,[797] Texas courts held that a corporation could not consolidate into another corporation "and impose responsibilities and hazards upon the minority not contemplated by the original enterprise;"[798] it could not "force a minority into such a scheme against their will, or compel them to accept an arbitrary value for their shares."[799] *International & Great Northern Railroad Company v. Bremond*[800] was a suit by a shareholder in the Houston & Great Northern Railroad Company against that corporation, its former directors, and the corporation surviving the merger, International & Great Northern Railroad Company. The plaintiff subscribed for $100,000 in stock in 1870 and had paid $40,000 in installment payments at the time of the merger.[801] At the time the plaintiff invested, the corporate charter did not provide for the ability to consolidate with another company. In 1874 though, the directors voted to merge the corporation with the International Railroad Company, under the name of the "International & Great Northern Railroad Company."[802] The legislature subsequently granted the surviving company a new charter and legalized the merger.[803] The plaintiff objected to the merger and sued for the value of his interest, which he claimed was worth $50,000,[804] and after a bench trial was awarded $43,182.30.[805] The appeal was taken to the Texas Supreme Court.

In addition to defending the legality of the merger, the defendants attacked the plaintiffs' lawsuit, claiming that it must be brought for the benefit of the corporation rather than as an individual action.[806] The defendants asserted that the "only cause of action which dissenting stockholders have, upon an ultra vires act, is in equity, and to compel restitution to the corporation, and not to themselves,[807] that the "plaintiff was not, in any case, entitled to recover damages payable to him personally," and that, even if the consolidation was ultra vires, it did not allow the plaintiff to rescind his subscription.[808] The plaintiff argued that the

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797 Currently codified at TEX. BUS. ORGS. CODE ANN. §§ 10.351–.901, 21.410 (West 2007).

798 Tipton v. Ry. Postal Clerks' Inv. Ass'n, 173 S.W. 562, 567 (Tex. Civ. App.—Fort Worth 1914, no writ).

799 Cattlemen's Trust Co. v. Beck, 167 S.W. 753, 755–56 (Tex. Civ. App.—Austin 1914, writ ref'd). They also could not dispose of all the assets of a solvent corporation without the unanimous consent of the stockholders. Aransas Pass Harbor Co. v. Manning, 63 S.W. 627, 628 (Tex. 1901).

800 53 Tex. 96 (1880).

801 *Id.* at 97.

802 *Id.*

803 *Id.* at 119–20 ("The consolidation, if illegal when attempted, has since been recognized by law, and for the purposes of this case must be regarded as an accomplished fact.").

804 *Id.* at 98.

805 *Id.* at 99.

806 *Id.* at 105–06.

807 *Id.* at 109.

808 *Id.* at 112.

merger "was ultra vires [under] the charter under which he became a stockholder,"[809] that it was "a breach of trust towards a stockholder in a joint stock incorporated company, established for a certain definite purpose by its charter, if the funds or credit of the company are diverted from such purpose, although the misapplication be sanctioned by a vote of a majority of the stockholders",[810] and that for "this breach of trust" the "dissenting stockholders have a cause of action against [the directors] and the company participating with them in the conversion and breach of trust."[811]

The Texas Supreme Court agreed with the plaintiff, holding first that the consolidation was "unauthorized and wrongful as to Bremond, an objecting stockholder of the former company, and having been consummated by a wrongful appropriation of his equitable interest by the consolidated company, that company became equitably liable to him therefor."[812] The plaintiff, however, was

> not entitled to the personal judgment against the director recovered by him. The consolidation was the act of the stockholders, other than the plaintiff, and was therefore an act for which the directors, as such, should not be held responsible. As directors, they were answerable to the corporation for official delinquencies resulting in damage to the corporate property.[813]

But the plaintiff *was* entitled to an equitable award of monetary damages against the corporation for the value of his shares.[814]

The defendants argued that the plaintiff should be limited to the market value of his stock, but the Court rejected that argument because it appeared that

> sales by subscribers were too rare to give the stock a market value. The inquiry should have extended to the actual value of stock, and as tending to show that value, the defendants were at liberty to show the true assets and liabilities of the Houston & Great Northern Railroad Company.[815]

The Court concluded that the trial court precluded the defendants from offering certain financial evidence about the corporation and reversed and remanded for a new trial.[816]

On another trial, the inquiry should be as to the real value of Bremond's equitable interest in the Houston & G. N. Railroad Co., or the real value of his stock at the time the consolidation was practically effected; or at any period thereafter up to the institution of his suit. His

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[809] *Id.* at 113.
[810] *Id.* at 114.
[811] *Id.* at 114–15.
[812] *Id.* at 117.
[813] *Id.* at 118.
[814] *Id.*
[815] *Id.* at 120.
[816] *Id.* at 121.

recovery should not exceed that value, with interest, from the institution of the suit.[817]

One commentator noted of *Bremond*: "This case is the only Texas decision prior to the adoption of the Business Corporation Act dealing with a party that can be analogized to a dissenting shareholder. It should be noted that the relief granted is identical to the recovery permitted under the appraisal procedure."[818] Effectively the same relief was developed in shareholder oppression cases by means of the buy-out remedy.

Therefore, in a case like *Boehringer v. Konkel*,[819] the majority shareholder wrongfully interfered with the plaintiff's rights to information,[820] and wrongfully denied plaintiff's right to "proportionate participation in the company's earnings as a shareholder"[821] through withholding dividends and granting himself "a de facto dividend"[822] of excessive compensation to the exclusion of the minority shareholder. The majority shareholder caused the corporation to impair the shareholders' interests, violate its duty of impartiality, and effectively deprived the plaintiff of his stock ownership rights. Such oppressive conduct effectively results in the "appropriation by the corporation" of the minority shareholder's "his stock or its fruits."[823] Such oppressive conduct so fundamentally changes the nature and terms of the investment for the minority shareholder—so thoroughly "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,"[824] if you will—that the oppressive conduct serves to "pervert or destroy the original purposes of the corporators,"[825] "impose [] hazards upon the minority not contemplated by the original enterprise,"[826] and to "force a minority into such a scheme against their will, [and attempt to] compel them to accept an arbitrary value for their shares."[827] In such cases, a buy-out should be ordered as an equitable remedy for the corporation's breach of trust.

## D. Other Issues

### *1. Joint and Several Liability of Controlling Shareholders*

"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

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817 *Id.*

818 Howard Wolf, *Dissenting Shareholders: Is the Statutory Appraisal Remedy Exclusive?*, 42 TEX. L. REV. 58, 63 (1963).

819 Boehringer v. Konkel, 404 S.W.3d 18 (Tex. App.—Houston [1st Dist.] 2013, no pet.).

820 *Id.* at 28.

821 *Id.* at 31.

822 *Id.*

823 Yeaman v. Galveston City Co., 167 S.W. 710, 723 (Tex. 1914).

824 Davis v. Sheerin, 754 S.W.2d 375, 381 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

825 Tipton v. Ry. Postal Clerks' Inv. Ass'n, 173 S.W. 562, 567 (Tex. Civ. App.—Fort Worth 1914, no writ).

826 *Id.*

827 Cattlemen's Trust Co. v. Beck, 167 S.W. 753,755–56 (Tex. Civ. App.—Austin 1914, writ ref'd). They also could not dispose of all the assets of a solvent corporation without the unanimous consent of the stockholders. *See* Aransas Pass Harbor Co. v. Manning, 94 Tex. 558, 562, 63 S.W. 627, 629 (1901).

is liable as such."[828] Therefore, the directors or the majority shareholder that cause or benefit from the corporate breach of trust will be individually liable.[829] If monetary relief is granted, then the majority shareholder may be jointly and severally liable. If injunctive relief is granted, it may be directed against the majority shareholder.

### *2. Statute of Limitations*

Because the corporation's duties arise out of the corporation's relationship as trustee to its shareholders, the four-year statute of limitations should apply to the breach of fiduciary duty claim.[830] In cases involving a pattern of disregard and impairment of the plaintiff's rights that may go on over a long period of time, limitations could become a significant issue. Oppressive conduct might seem like isolated disagreements or minor overreaching at first, but when the conduct escalates over time, the question of when the breach of trust actually happened could become difficult. However, the Texas Supreme Court in *Yeaman* ruled that a "shareholder is entitled to rely upon [the corporation] not attempting to impair his interest. He is chargeable with no vigilance to preserve his stock or its fruits from appropriation by the corporation, but may confide in its protection for their security."[831] Therefore, "statutes of limitation have no application until there is a clear and unequivocal disavowal of the trust, and notice of it brought to the cestui que trust."[832] The shareholder must have notice of overt conduct by the corporation denying or repudiating his interests.[833] One court noted:

> Given that repudiation triggered accrual, it was conceivable that situations could arise, when dealing with dividends or preemptive rights, where the corporation did nothing to repudiate them and the shareholder did nothing to secure them. Should that circumstance have occurred, then limitations would never have begun. . . . Had that occurred, limitations would never have begun, and the corporation would have been perpetually liable.[834]

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[828] City of Fort Worth v. Pippen, 439 S.W.2d 660, 665 (Tex. 1969); Kinzbach Tool Co. v. Corbett-Wallace Corp., 160 S.W.2d 509, 514 (Tex. 1942).

[829] Cotten v. Weatherford Bancshares, Inc., 187 S.W.3d 687, 701 (Tex. App.—Fort Worth 2006, pet. denied) ("A corporate officer may be held individually liable for a corporation's tortious conduct if he knowingly participates in the conduct or has either actual or constructive knowledge of the tortious conduct.") *disapproved of on other grounds by*, Ritchie v. Rupe, 443 S.W.3d 856 (Tex. 2014).

[830] TEX. CIV. PRAC. & REM. CODE ANN. § 16.004(5) (West 1999).

[831] Yeaman v. Galveston City Co., 167 S.W. 710, 723 (Tex. 1914).

[832] *Id.* at 723–24. *Accord* Bennett v. Hibernia Bank, 305 P.2d 20, 34 (Cal. 1956) ("Since a fiduciary has a duty to make a full disclosure of facts which materially affect the rights of the parties, it seems obvious that any act by him amounting to a conversion of trust property is akin to a fraudulent concealment."); Schneider v. Union Oil Co., 86 Cal. Rptr. 315, 319 (Cal. Ct. App. 1970) (emphasizing the "shareholder's right to believe that the corporation would not assert a claim adverse to his rights until he had notice of some unequivocal act that his rights were being disputed. Similarly here, until plaintiff received such notice, she had the right to regard defendant as holding her interest in the corporation in trust for her.").

[833] Disco Mach. of Liberal Co. v. Payton, 900 S.W.2d 124, 126 n.2 (Tex. App.—Amarillo 1995, writ denied) ("Consequently, claims against the corporation involving his interest in the stock and its fruits did not accrue until the corporation undertook some overt conduct denying or repudiating the interest.").

[834] *Id*. That result was exactly the situation in *Yeaman* in which the corporate defendant failed to recognize the ownership interests of a shareholder and the claim brought 72 years later by his descendants was not time-barred.

### *3. Burden of Proof*

Because the corporation is a trustee with fiduciary duties to the shareholder, the corporation should have the burden of proving that its conduct was consistent with its duties.[835] Texas courts apply a presumption of unfairness to transactions between a fiduciary and a party to whom he owes a duty of disclosure.[836] Thus, the profiting fiduciary bears the burden of showing the fairness of the transactions.[837] Such fiduciaries must prove they acted in good faith and that the transactions were fair, honest, and equitable.[838]

### *4. Business Judgment Rule*

When corporate action is utilized to impair fundamental shareholder rights and interests in breach of the corporation's trust relationship with its shareholders, the business judgment rule should have no application. The business judgment rule exists to protect officers and directors from liability to the corporation as a consequence of poor, but honest, decisions.[839] The duties that corporations owe to their shareholders are different from the duties that directors owe to the corporation, and there is no reason to assume that the business judgment rule would apply.[840] There is no authority that the business judgment rule protects the corporation from liability to its shareholders. If a corporate president makes a poor decision that results in the corporation breaching a contract with a third party or negligently harming a third party, the

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[835] Tex. Bank & Trust Co. v. Moore, 595 S.W.2d 502, 509 (Tex. 1980) ("It should be emphasized that the imposition by equity of a fiduciary relationship in such circumstances does no more than cast upon the profiting fiduciary the burden of showing the fairness of the transactions.").

[836] Fitz-Gerald v. Hull, 237 S.W.2d 256, 261 (Tex. 1951).

[837] Collins v. Smith, 53 S.W.3d 832, 840 (Tex. App.—Houston [1st Dist.] 2001, no pet.).

[838] Lee v. Hasson, 286 S.W.3d 1, 21 (Tex. App.—Houston [14th Dist.] 2007, pet. denied). *See also* Estate of Miller, 446 S.W.3d 445, 453 (Tex. App.—Tyler 2014, no pet.) ("This places the burden on the fiduciary to rebut the presumption by establishing the fairness of the transaction with his principal."); Vogt v. Warnock, 107 S.W.3d 778, 783 (Tex. App.—El Paso 2003, pet. denied) ("The court also observed that the fiduciary relationship did no more than cast upon the profiting fiduciary the burden of showing the fairness of the transactions."); Procom Energy, L.L.A. v. Roach, 16 S.W.3d 377, 382 (Tex. App.—Tyler 2000, pet. denied) ("Additionally, where an issue is raised as to the fairness of a confidant or fiduciary in this type of transaction, the burden of proof is imposed upon that individual who refuses to convey the withheld interest to fully disclose the facts and circumstances that would demonstrate his good faith in his conduct."); Zieba v. Martin, 928 S.W.2d 782, 789 (Tex. App.—Houston [14th Dist.] 1996, no writ) ("In that circumstance, the burden of proof to show fairness in disposing of community assets is upon the disposing spouse."); Corpus Christi Bank & Trust v. Roberts, 587 S.W.2d 173, 181–82 (Tex. Civ. App.—Corpus Christi 1979), *reformed in part and aff'd in part*, 597 S.W.2d 752 (Tex. 1980) ("[T]he burden of proving the propriety of acts set forth in the account, if they are objected to, should rest on the trustee . . . ."); Graham v. Turner, 472 S.W.2d 831, 840 (Tex. Civ. App.—Waco 1971, no writ) ("Although the burden of proof is initially on the person seeking to impose the constructive trust to trace the funds into the specific property sought to be recovered, once this burden is satisfied, (as in the instant case), the burden of proof shifts to the constructive trustee to show that the part of the fund used to purchase the properties was his money only. Otherwise, the whole fund is treated as trust property.").

[839] Sneed v. Webre, 465 S.W.3d 169, 173 (Tex. 2015) (citing Cates v. Sparkman, 11 S.W. 846, 848–49 (Tex. 1889)).

[840] In *Ritchie*, the majority refuted the assumption by the dissent that the business judgment rule would apply to breach of fiduciary duty claims brought by shareholder on the basis of relationships of trust and confidence. The majority wrote, "We see no basis for such an assumption and not that Texas law recognizes different kinds of fiduciary duties owed under different circumstances. . . . [W]e see no reason to assume the [business judgment] rule would apply [to different fiduciary duties]." Ritchie v. Rupe, 443 S.W.3d 856, 874 n.27 (Tex. 2014).

president would not be liable to the company, but the company will still be liable to the third party. The duties that corporations owe to their shareholders constrain corporate action. Acting to extinguish a shareholder's ownership interest (either actually or constructively) is not one of those things that corporations have the right to do.[841] The Texas Supreme Court in *Yeaman* was "unwilling to affirm that, in the absence of some statutory or charter power, or express consent to that effect, a corporation has any authority to forfeit a stockholder's shares."[842] It must be noted that, although the *Patton* Court relied on the *Cates* decision[843]—a fact that the *Ritchie* Court found extremely significant in its analysis of *Patton*[844]—the *Patton* opinion never mentioned the business judgment rule or made the least inquiry into whether the majority shareholder in that case was accorded any discretion in the dividend decisions that he made.

2015 Amendments to the Business Organizations Code

A significant legislative development after the *Ritchie* opinion may also have an effect on the ability of individual shareholders to obtain equitable relief for oppressive conduct. Subchapter R to the Chapter 21 of the Code became effective on September 1, 2015.[845] Among other changes, the new subchapter creates a new judicial proceeding to challenge the validity of corporate acts and transactions.[846] An individual shareholder[847] or a member of the board of directors[848] may bring an action to have the court "determine the validity and effectiveness of" a "defective corporate act."[849] A "defective corporate act" is defined as including "any act or transaction purportedly taken by or on behalf of the corporation that is, and at the time the act or transaction was purportedly taken would have been, within the power of a corporation to take under the corporate statute, but is void or voidable due to a failure of authorization."[850] A "failure of authorization" means "the failure to authorize or effect an act or transaction in compliance with the provisions of the corporate statute, the governing documents of the corporation, or any plan or agreement to which the corporation is a party, if and to the extent the failure would render the act or transaction void or voidable."[851] Shareholders and directors may also bring an action to "determine the validity of any corporate act or transaction"[852] This claim would obviously encompass a broader category of corporate acts and transactions, which might not be void or voidable, and which might be invalid for other reasons, such as a violation of fiduciary duties to the corporation, a violation of the shareholder's common-law property rights, a violation of the corporation's duties to the individual shareholder. In determining the validity of the challenged acts or transactions, the court is empowered to base its determination on any "factors or considerations the district court considers just and

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841 *Cates*, 11 S.W. at 620.

842 Yeaman v. Galveston City Co., 167 S.W. 710, 723 (Tex. 1914).

843 Patton v. Nicholas, 279 S.W.2d 848, 854 (Tex. 1955).

844 *Ritchie*, 443 S.W.3d at 876.

845 TEX. BUS. ORGS. CODE ANN. §§ 21.901–.917 (West 2015).

846 *See id*. § 21.914.

847 *Id.* at (a)(4).

848 *Id.* at (a)(3).

849 *Id.* at (b)(3)(B).

850 *Id.* § 21.901(2)(c).

851 *Id.* at (4).

852 *Id.* § 21.914(b)(4).

equitable."[853] In addition to making a declaration as to the validity of the challenged act, the court is also empowered to "make any other order regarding such matters as the court considers appropriate under the circumstances"[854]—a grant of authority that would necessarily include the ability to award a compulsory buy-out. It is important to remember that the *Ritchie* opinion did not hold that courts do not have the equitable power to order a buy-out, but only that Section 11.404 of the Business Organizations Code did not provide such a remedy and that no common-law cause of action for shareholder oppression provided a vehicle for such an equitable remedy. Even aside from the common-law breach of trust cause of action developed here, it appears that the Texas legislature has furnished such a vehicle by statutory enactment.

## VIII. OTHER SHAREHOLDER CAUSES OF ACTION ARISING FROM CORPORATE TRUST DUTIES

### A. Ultra Vires

*Cates v. Sparkman* held that an individual shareholder is entitled to bring a claim against the corporation for actions that are "ultra vires."[855]

#### *1. Elements*

Under Texas law, ultra vires acts are "acts beyond the scope of the powers of a corporation as defined by its charter or the laws of the state of incorporation."[856] Under modern law, a Texas corporation's certificate of formation may state that it is created to pursue any lawful purpose.[857] Therefore, truly "ultra vires" acts, in the sense that the corporation had no power to enter into the transaction or was affirmatively prohibited from doing so, are exceedingly rare.[858] Nevertheless, the ultra vires doctrine potentially remains useful in shareholder oppression disputes. Corporate action must be taken for the benefit of the corporation and comply with state law,[859] including "basic principles of fiduciary law."[860] Corporate actions "must be pursued for corporate benefit. If pursued for personal benefit, they are ultra vires."[861] While misappropriation and other self-dealing transactions by the controlling majority may be the basis of a derivative claim for damages, such transactions may

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853 *Id.* at (d)(5).

854 *Id.* at (c)(10).

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

856 F.D.I.C. v. Benson, 867 F. Supp. 512, 521 (S.D. Tex. 1994); *see also* Gearhart Indus., Inc. v. Smith Int'l, Inc., 741 F.2d 707, 719 (5th Cir. 1984) ("The duty of obedience requires a director to avoid committing ultra vires acts, i.e., acts beyond the scope of the powers of a corporation as defined by its charter or the laws of the state of incorporation.").

857 *See* TEX. BUS. ORGS. CODE ANN. § 3.005(a)(3) (West 2007).

858 "[M]ost ordinary business activities are now intra vires . . . ." TEX. PRAC.: BUS. ORGS., *supra* note 7, at § 27:9.

859 *See* Religious Films v. Potts, 197 S.W.2d 592, 594 (Tex. Civ. App.—Galveston 1946, no writ) ("The test generally applied is that if the act is not one prohibited by law or by public policy, and it inures to the direct benefit of the corporation and is executed, it is not, strictly speaking, ultra vires.").

860 Solomon v. Armstrong, 747 A.2d 1098, 1114 n.45 (Del. Ch. 1999), *aff'd*, 746 A.2d 277 (Del. 2000).

861 TEX. PRAC.: BUS. ORGS., *supra* note 7, at § 27:9. *See, e.g.*, Inter-Cont'l Corp. v. Moody, 411 S.W.2d 578, 587 (Tex. Civ. App.—Houston 1966, writ ref'd n.r.e.) ("The payment of an officer's debt is ultra vires.").

be ratified by a majority of disinterested directors or shareholders.[862] The definition of "disinterested" under the Code is quite broad and can include allies, friends, and stooges.[863] However, ultra vires acts that do not benefit the corporation, such as those constituting waste[864] or gift,[865] may only be ratified by a unanimous shareholder vote.[866] Furthermore, the business judgment rule does not insulate ultra vires acts.[867]

A second area in which the ultra vires doctrine comes into play is when the officers, directors, or other corporate agents take the corporate action without authority.[868] These acts are not truly "ultra vires" in the sense that they may be ratified after the fact,[869] nevertheless they are void unless and until ratification occurs, and may be the subject of an ultra vires claim. Such ultra vires acts of officers and directors very frequently occur in shareholder oppression litigation in the course of excluding the minority shareholder from participation, particularly if the minority shareholder is a director. Often the board will be in deadlock, or the controlling shareholder does not wish to meet with the minority shareholder, and the controlling shareholder proceeds to act outside the board process. Action by written consent by

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[862] BUS. ORGS. §21.418 (b).

[863] *See id.* §1003.

[864] *See* Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 897 (Del. Ch. 1999) (recognized that waste is a "vestige" of the ultra vires doctrine).

[865] "Void acts include fraud, gift, waste, or *ultra vires* acts." *Solomon*, 747 A.2d at 1114.

[866] TEX. PRAC.: BUS. ORGS., *supra* note 7, at § 27:9 n.5. *See* Gantler v. Stephens, 965 A.2d 695, 713 n.54 (Del. 2009). The unanimity requirement derives from the theory that no one "should be forced against their will to make a gift of their property." Lewis v. Vogelstein, 699 A.2d 327, 335–36 (Del. Ch. 1997). *See also* Rogers v. Hill, 289 U.S. 582, 591–92 (1933) ("If a bonus payment has no relation to the value of services for which it is given, it is in reality a gift in part, and the majority stockholders have no power to give away corporate property against the protest of the minority."); *Solomon*, 747 A.2d at 1114 ("No amount of shareholder ratification validates acts repugnant to public policy (*e.g.,* fraud), and which are therefore void *ab initio.* In other words, those acts may still be subject to this Court's equitable powers (*e.g.,* rescission). Other than void acts [gift, waste, or *ultra vires* acts] precluded by public policy concerns, fully informed shareholder ratification will insulate a board action from subsequent legal attack by shareholders. The restriction is that only a *unanimous* shareholder vote can ratify these remaining void acts."); Michelson v. Duncan, 407 A.2d 211, 219 (Del. 1979) ("It is only where a claim of gift or waste of assets, fraud or Ultra vires is asserted that a less than unanimous shareholder ratification is not a full defense.").

[867] F.D.I.C. v. Benson, 867 F. Supp. 512, 521 (S.D. Tex. 1994) ("To avoid the protective shield of the business judgment rule, [the plaintiff] must show that the acts of the directors and officers were ultra vires*,* or tainted by fraud, or a complete abdication of duty . . . ."); *see also* Fisher v. Shipyard Vill. Council of Co-Owners, Inc., 760 S.E.2d 121, 130 (S.C. Ct. App. 2014), *aff'd as modified*, 781 S.E.2d 903 (S.C. 2016) ("The business judgment rule only applies to *intra vires* acts, not *ultra vires* ones.").

[868] Governing Bd. v. Pannill, 561 S.W.2d 517, 524 (Tex. Civ. App.—Texarkana 1977, writ ref'd n.r.e.) ("That a corporate act is invalid because it was beyond the authority of officers or directors may be asserted by a member in an action against the corporation to enjoin the activity."). *See also* Ravenswood Inv. Co., L.P. v. Bishop Capital Corp., 374 F. Supp. 2d 1055, 1066–67 (D. Wyo. 2005) (issuing shares to the individual Defendants at a reduced price and failing to hold annual shareholder meetings stated a claim for ultra vires acts); Woods v. Wells Fargo Bank Wyoming, 90 P.3d 724, 733 (Wyo. 2004) ("Ultra vires acts of a corporate president or other agent are void"); Gooding v. Millet*,* 430 So.2d 742, 743–44 (La. Ct. App.1983) (noting that the lack of shareholder meetings contributed to finding that directors of corporation had committed ultra vires acts).

[869] Shoen v. SAC Holding Corp., 137 P.3d 1171, 1186 (Nev. 2006) ("Thus, for example, '[i]f . . . the [corporation's] act was within the corporate powers, but was performed without authority or in an unauthorized manner, the act is not ultra vires.'"); 7A FLETCHER CYC. CORP. § 3401 ("A result of this distinction is that while the shareholders cannot by ratification render valid an act that is beyond the powers of the corporation, they may ratify an act that is within its powers but beyond the powers of the directors.").

the majority shareholder is not valid, unless the Certificate of Formation—not the bylaws—specifically provides for nonunanimous written consent.[870] Often shareholder or board-level decisions will be made without notice to the minority shareholder. "The general rule is that a board of directors may exercise its power only as a body at a meeting duly assembled."[871] Board members have no authority to act individually, or without a properly noticed meeting. Board-level actions taken without proper notice to all board members are void.[872] In many instances, the controlling shareholder will attempt to exercise control over the corporation as its president, bypassing board and shareholder votes. However, a president's authority only extends to matters in the ordinary course of business.[873] The president has no authority to fire an officer appointed by the board.[874] Similarly, the president has no authority to cause the corporation to hire counsel to fight with the minority shareholder.[875]

### *2. Remedies*

A shareholder may sue the corporation directly for injunctive relief to restrain or set aside

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[870] TEX. BUS. ORGS. CODE ANN. § 6.202 (West 2006).

[871] Am. Bank & Trust Co. v. Freeman, 560 S.W.2d 444, 446 (Tex. Civ. App.—Beaumont 1977, writ ref'd n.r.e.); *see* Whitaker v. Vastine, 601 S.W.2d 398, 403 (Tex. Civ. App.—Dallas 1980, writ ref'd n.r.e.); Dowdle v. Tex. Am. Oil Corp., 503 S.W.2d 647, 652 (Tex. Civ. App.—El Paso 1973, no writ); Curtis v. Pipelife Corp., 370 S.W.2d 764, 767 (Tex. Civ. App.—Eastland 1963, no writ); Holloway v. Int'l Bankers Life Ins. Co., 354 S.W.2d 198, 214 (Tex. Civ. App.—Fort Worth 1962), *rev'd on other grounds*, 368 S.W.2d 567 (Tex. 1963); Wichita Falls Electric Co. v. Huey, 246 S.W. 692 (Tex. Civ. App.—Amarillo 1922, no writ); Nicholstone City Co. v. Smalley, 51 S.W. 527, 529 (Tex. Civ. App. 1899, no writ).

[872] *See* Greater Fort Worth & Tarrant Co. Cmty. Action Agency v. Mims, 627 S.W.2d 149, 151 (Tex. 1982) ("The Board was illegally constituted so it had no authority to terminate Mims. Until the Board was properly constituted, it could not ratify its earlier unauthorized acts."). *See also* Rare Earth, Inc. v. Hoorelbeke, 401 F. Supp. 26, 32 (S.D.N.Y. 1975) (where a written notice of the meeting of the board of directors is not given although required by either a statute or the corporate bylaws, any action taken by the meeting at which all the directors are not present is void); Schroder v. Scotten, Dillon Co., 299 A.2d 431, 435 (Del. Ch. 1972) (decisions made at a Board of Directors meeting held without due notice to all directors as required by the by-laws is not lawful and all acts done at such meeting are void); Moore Bus. Forms, Inc. v. Cordant Holdings Corp. (Moore II), No. 13911, 1998 WL 71836, at *7 (Del. Ch. Feb. 4, 1998) (same); 2 FLETCHER CYC. CORP. § 428 ("However, proceedings by directors at a meeting that was illegal because it was not called by the authority or in the mode prescribed by the articles of incorporation or bylaws, or because notice was not given to absent members of the board, or because a quorum was not present, or for any other reason, as explained in the preceding sections, are absolutely void, unless they are afterwards ratified, or unless the corporation is estopped as against innocent third persons.").

[873] Templeton v. Nocona Hills Owners Ass'n, Inc., 555 S.W.2d 534, 538 (Tex. Civ. App.—Texarkana 1977, no writ) ("[T]he settled rule in Texas is that a corporation president, merely by virtue of his office, has no inherent power to bind the corporation except as to routine matters arising in the ordinary course of business.").

[874] *See In re* Walt Disney Co. Deriv. Litig., No. 15452, 2005 WL 2056651, at *49 n.571 (Del. Ch. Aug. 9, 2005), *aff'd*, 906 A.2d 27 (Del. 2006) ("[A]bsent express authority, the presiding officer of a corporation has no power to remove an officer appointed by the board of directors where the power of removal is in the board.").

[875] *In re* CorrLine Int'l, L.L.C., 516 B.R. 106, 138 (Bankr. S.D. Tex. 2014). Defending a lawsuit and hiring counsel to pursue or defend litigation is not within the "ordinary course of business." *See* Kaspar v. Thorne, 755 S.W.2d 151, 154 (Tex. Civ. App.—Dallas 1988, no writ); St. Star Designs, L.L.C. v. Gregory, No. H–11–0915, 2011 WL 3925070, at *3 (S.D. Tex. Sept. 7, 2011); Square 67 Dev. Corp. v. Red Oak State Bank, 559 S.W.2d 136, 138 (Tex. Civ. App.–Waco 1977, writ ref'd). *See also* Robert Nanney Chevrolet Co. v. Evans & Moses, 601 S.W.2d 411, 413 (Tex. Civ. App.—Beaumont 1980, no writ) ("Hiring of counsel in an attempt to thwart the will of the majority of the Board of Directors and the holders of the stock of the corporation is not, as a matter of law, a routine matter arising in the ordinary course of business.").

ultra vires acts. The Business Organizations Code provides that

> an act or transfer [] beyond the scope of the expressed purpose or purposes of the corporation or [] inconsistent with an expressed limitation on the authority of an officer or director may be asserted in a proceeding . . . by a shareholder or member against the corporation to enjoin the performance of an act or the transfer of property by or to the corporation.[876]

Shareholders may also bring claims for ultra vires acts against officers and directors, but only derivatively.[877] However, the remedy for an ultra vires claim brought by or on behalf of the corporation is not limited to injunctive relief.

### B. Fraud in the Purchase of Minority Shares

*Cates v. Sparkman* held that an individual shareholder is entitled to bring a claim against the corporation for "fraud."[878] Corporations rarely enter into transactions with existing shareholders in their capacity as shareholders, as opposed to officer, director, employee, lender, lessor, vendor, etc., other than in the repurchase or redemption of the shareholder's stock. Redemption or repurchase of the minority shareholder's stock is very common in successful squeeze-outs, and the corporation's duties as trustee permit the shareholder to sue for fraud or breach of fiduciary duties if information is withheld or the transaction is otherwise for less than fair value.

#### *1. Duty Owed to Minority Shareholders*

In *In re Fawcett*, the widow of a shareholder in a closely-held corporation entered into an agreement with the corporation providing for the corporation to repurchase her shares.[879] She later sued the corporation for fraud and breach of fiduciary duties because the corporation and the other shareholders failed to disclose the existence of a significant business opportunity that the corporation commenced within days after signing the agreement, and which would have greatly increased the value of her shares. The court of appeals held that there was a fact issue as to the existence of fiduciary duties owed to the individual shareholder under the circumstances.[880] "An officer or director of a closely held corporation, as well as the corporation itself, may become fiduciaries to a shareholder when the corporation, officer, or director repurchases the shareholder's stock."[881] Subsequent cases have cited *In re Fawcett* for the proposition that fiduciary relationships may be created by contract, through the repurchase

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[876] TEX. BUS. ORGS. CODE ANN. § 20.002(c)(1) (West 2006). *See* Inter-Cont'l Corp. v. Moody, 411 S.W.2d 578, 587 (Tex. Civ. App.—Houston 1966, writ ref'd n.r.e.) ("Any shareholder has his remedy, if equitably entitled to relief, through a suit to enjoin performance of the particular act.").

[877] *See* BUS. ORGS. § 20.002(c)(2); *Inter-Cont'l Corp.*, 411 S.W.2d at 587 ("The corporation or its representatives or a shareholder have their remedy by suing the officers and directors.").

[878] Cates v. Sparkman, 11 S.W. 846, 849 (Tex. 1889).

[879] Estate of Fawcett, 55 S.W.3d 214, 216 (Tex. App.—Eastland 2001, pet. denied).

[880] *Id.* at 220.

[881] *Id.* (citing Miller v. Miller, 700 S.W.2d 941, 945–46 (Tex. App.—Dallas 1985, writ ref'd n.r.e.)); WILLIAM MEADE FLETCHER ET AL., 12B FLETCHER CYC. CORP. § 5811.05 (perm. ed., rev. vol. 2000).

of a shareholder's stock in a closely held corporation.[882] However, it is clear from the opinion that the contract itself did not create fiduciary duties; rather it was the occasion of entering into the contract that resulted in the application of fiduciary duties that already existed in the relationship between the corporation and its shareholder.

The same duties are imposed on controlling shareholders and directors by implication if they use their position of control over the corporation and insider information to take unfair advantage in purchasing minority shareholder interests. In *Miller v. Miller*,[883] the court addressed duties of controlling shareholders in purchasing shares from minority shareholders. Certain aspects of the case are unusual, and the case probably could have been resolved without reference to the corporate law issues. The case arose out of a divorce between a husband and wife. The husband had started a corporation with three other engineers, each of whom were issued 25% of the shares.[884] The husband was an officer and director. None of the shares were in the wife's name; her interests were purely the result of community property. At the time that the corporation was organized, the husband and wife were already separated. The purpose of the corporation was to develop and market some extremely promising telephone switching technology. A subsidiary of Exxon had agreed to provide venture capital and to take a significant equity stake.

Exxon required, as a condition of its investment, that the shareholders enter into a shareholders' agreement restricting the sale of their shares. One of the provisions required any divorcing spouse of the shareholders to sell any shares owned by them back to the shareholder spouse, to the corporation or to the other shareholders at a price determined by a formula that was guaranteed to result in a relatively low price.[885] All of the spouses were required to sign. The husband presented the agreement to the wife, and explained that it was an agreement between Exxon and the founders and was necessary to get the company started. He did not explain the agreement and did not disclose the facts he knew about the prospects of the company, the size of Exxon's investment or the price per share paid by Exxon, or the potential value of the enterprise. The wife read the agreement and signed it and later testified that she had believed that she was already bound by it.

The husband's 700,000 shares apparently were not dealt with in the divorce, but were treated as his separate property, and he never demanded that she sell the shares or offered her the consideration under the agreement, which he contended was $2,500. Two years later, the wife later learned that the corporation was worth far more than she had believed. She sued to rescind the agreement and partition the shares.[886] The case was tried to a jury, which found the affirmative representations made by the husband were false and material and that the husband had failed to disclose that Exxon had purchased 1.5 million shares at $1 per share, that the wife would be required to sell in the event of a divorce, that the stock had a fair market cash value,

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[882] *See In re* Rosenbaum, No. 08-43029, 2010 WL 1856344, at *7 (Bankr. E.D. Tex. May 7, 2010). *See also* Redmon v. Griffith, 202 S.W.3d 225, 237 (Tex. App.—Tyler 2006, pet. denied) ("[F]iduciary relationship that may exist between majority and minority shareholders . . . by contract . . . ."); *accord* Willis v. Donnelly, 118 S.W.3d 10, 31, 33 (Tex. App.—Houston [14th Dist.] 2003) *rev'd in part on other grounds*, 199 S.W.3d 262 (Tex. 2006).

[883] 700 S.W.2d 941 (Tex. App.—Dallas 1985, writ ref'd n.r.e.).

[884] *Id.* at 943.

[885] *Id.*

[886] *Id.* at 944.

and that the corporation was developing technology that would be in great demand. However, the jury also found that the husband did not act with the intent to deceive. With regard to breach of fiduciary duties, the jury found that the husband had acted in good faith, that the agreement had a reasonable business purpose, but that the agreement was unfair to the wife.[887] On the basis of these findings, the trial court denied rescission of the shareholder's agreement and ordered that the wife be paid the amount due under the shareholders' agreement.

The wife appealed only the breach of fiduciary duties. The jury had found a confidential relationship, and certain fiduciary duties would have existed as a matter of law by virtue of the marriage relationship. However, the court of appeals' analysis places primary emphasis on the husband's power over the wife's stock rights as a result of his controlling position in the corporation:

> The record shows that as a founder, officer, and director of InteCom, Howard had an insider's knowledge of the affairs and prospects of the corporation. . . . Recognition of a fiduciary duty in this case is based not only on the personal relationship between Howard and Judy but also on Howard's position as a founder, officer, and director of InteCom.[888]

The court noted that no Texas case had addressed the issue of whether an officer and director of a corporation has a duty to disclose to a stockholder his knowledge of information affecting the value of the stock before purchasing it from the stockholder.[889] The court noted that majority rule was that a director or officer does not stand in a fiduciary relation to a stockholder in respect to his stock and, therefore, has the same right as any other stockholder to trade freely in the corporation's stock.[890]

However, some jurisdictions had held that officers and directors have a fiduciary duty to individual stockholders, as well as to the corporation itself and, thus, cannot properly purchase stock from a stockholder without giving him the benefit of any official knowledge they have of information that may increase the value of the stock.[891] Still other courts had followed the majority rule, but recognized an exception when "special facts" impose on the officer or director a limited fiduciary duty to disclose any knowledge of special matters relating to the corporate business—e.g., merger, assured sale, etc.—that may affect the value of the stock.[892]

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[887] *Id.*

[888] *Id.* at 945.

[889] *Id.* at 946.

[890] *Id.* at 945–46 (citing Seitz v. Frey, 188 N.W. 266, 268 (Minn. 1922)); Schuur v. Berry, 281 N.W. 393, 395 (Mich. 1938).

[891] *Id.* at 946 (citing Dawson v. Nat'l Life Ins. Co., 157 N.W. 929, 934 (Iowa 1916)); *see* Jacobson v. Yaschik, 155 S.E.2d 601, 605 (S.C. 1967); *cf.* Harris v. Mack, No. SA:11-CV-00622-DAE, 2013 WL 416299, at *4 (W.D. Tex. Jan. 31, 2013) (affirming summary judgment for majority shareholder on minority shareholder's fraud by nondisclosure claim because majority shareholder did not owe a fiduciary duty to disclose information to minority shareholder); Jones v. Sherman, 857 S.W.2d 468, 468 (Mo. Ct. App. 1993) ("Neither closely held corporation nor majority shareholder had duty to disclose financial information to minority shareholder while negotiating to buy out minority shareholder.").

[892] Miller v. Miller, 700 S.W.2d 941, 946 (Tex. App.—Dallas 1985, writ ref'd n.r.e.) (citing Strong v. Repide, 213 U.S. 419, 431 (1909)); Hobart v. Hobart Estate Co., 159 P.2d 958, 969–70 (Cal. 1945); 3A FLETCHER § 1171.

The court declined to rule whether Texas would follow the "majority" or "minority" rule, but held that even under the majority rule the "special facts" of this case were sufficient to bring it within the exception.[893] The "special facts" critical to the court's decision were that the husband knew that "Exxon was purchasing 1,500,000 shares at one dollar per share and that if IBX was developed, it would be in great demand" and that the husband therefore had a fiduciary duty to disclose those facts prior to contracting with the wife regarding the ownership of her shares.[894]

In *Westwood v. Continental Can Co.*,[895] the Fifth Circuit decided a case involving a shareholder and managing director of a Texas corporation who negotiated a deal sell the stock of his corporation, and then negotiated option agreements with all the stockholders that would permit him to buy their stock and resell it at a premium. Ultimately, the buyer refused to consummate the transaction, and the shareholder sued for breach of contract. The buyer successfully defended the action on the grounds that the contract was unenforceable because it constituted a breach of the shareholder's fiduciary duties to the corporation and its shareholders.

The Fifth Circuit held that the contract was unenforceable because

> when directors or other officers step aside from the duty of managing the corporate business under the charter for the benefit of stockholders, and enter upon schemes among themselves or with others to dispose of the corporate business and to reap a personal profit at the expense of the stockholders by buying up their shares without full disclosure and at an inadequate price, there is a breach of duty.[896]

If a favorable opportunity arises to sell out, the stockholders and not the managing officers are entitled to have the benefit of it. If an agreement cannot be reached by the stockholders, no doubt one faction may buy out the other.[897]

Any shareholder, even though an officer and director, could legally buy up the stock of the other shareholders with the purpose of reselling at a profit, but only on full disclosure.[898] The shareholder had disclosed to the other shareholders in a letter "the state of the business, the want of harmony among the stockholders, and the wisdom of acting promptly to save the investment."[899]

"In making his offer for the stock, he stated that he proposed to resell it as an entirety, and if unable to do so, to dissolve the corporation and dispose of the assets, hoping to make a profit as the reward of his risk and efforts."[900] He had even disclosed that he was in the process of

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893 *Miller*, 700 S.W.2d at 946.
894 *Id.*
895 80 F.2d 494, 498 (5th Cir. 1935).
896 *Id.*
897 *Id.*
898 *Id.*
899 *Id.*
900 *Id.*

carrying on negotiations for a possible sale.[901] However, in the lawsuit, the shareholder contended that he in fact had a contract with the buyer; and the court held that, if so, "the plan as a whole was thus one for the managing officer to deceive the stockholders and acquire the corporate assets for his own and another's profit."[902]

Both *Miller* and *Westwood* involved shareholders who were also officers and directors, and both opinions emphasize their duties as officer and directors. Neither was a derivative action—in *Miller*, the plaintiff was suing individually, and in *Westwood* the corporation was not involved in the transaction. The duties of disclosure in these cases are best understood as flowing from the corporation's duties to its shareholders, with the courts imposing those same duties on the officer/director defendants because of their control of the corporation. If a corporation could not enter into a transaction or purchase shares from a shareholder because the corporation was in possession of undisclosed, material information, then an officer or director who is in the same position of advantage over the shareholder as a result of his control over a corporation is subjected to the same duties of disclosure.

*Allen v. Devon Energy Holdings, L.L.C.* concerned the redemption of Allen's minority interest in an LLC involved in natural gas exploration and development.[903] The LLC redeemed Allen's interest in 2004 based on a 2003 $138.5 million appraisal of the LLC.[904] Approximately 18 months after the redemption, however, the LLC was sold for $2.6 billion—almost twenty times the value used to calculate the redemption price.[905] Allen sued, claiming that the majority shareholder and the LLC made misrepresentations, failed to disclose facts regarding the LLC's future prospects, and that Allen would not have sold his interest in 2004 if he had known these material facts.[906] For instance, the majority shareholder withheld information concerning the LLC's technological advances in horizontal drilling and significant lease acquisitions in an existing natural gas field, both of which occurred after the redemption offer but before the redemption.[907]

Although the transaction was a redemption in which the company was the purchaser, the court of appeals treated the transaction as though it were a purchase by the majority shareholder. "We note that the duty we recognize is owed by Rees-Jones, a majority owner and manager with virtually unmitigated control over an LLC, not [the LLC] itself—whether [the company] owed Allen any fiduciary duties is not before this Court."[908] The appellate court determined that a majority shareholder owed a fiduciary duty to a minority shareholder in the context of a redemption agreement. The court based its decision on majority shareholder's operating control over the affairs of the company and intimate knowledge of the company's daily affairs and future plans.[909] Further, the purchase of a minority owner's interest benefitted

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[901] *Id.*

[902] *Id.*

[903] Allen v. Devon Energy Holdings, L.L.C., 367 S.W.3d 355 (Tex. App.—Houston [1st Dist.] 2012, pet. granted, judgm't vacated w.r.m.).

[904] *Id.* at 365–66.

[905] *Id.* at 367.

[906] *Id.* at 365.

[907] *Id.*

[908] *Id.* at 395.

[909] *Id.* at 392.

the majority owner.[910]

*Ritchie*'s treatment of this line of authority is significant.[911] The majority opinion cited *Allen* as authority for the ability of individual shareholders to sue directors and majority shareholders for "fraudulently [] manipulat[ing] the shares' value" under existing causes of action. *Fawcett*, *Miller*, and *Allen* all clearly recognize that officers, directors, and controlling shareholders owe fiduciary duties to minority shareholders at least in the context of a transaction to purchase the minority's shares when there is knowledge of material facts within the corporation not disclosed to the shareholder. At first glance, the holdings of this line of cases, which *Ritchie* cites with approval, seems grossly at odds with the holding in *Ritchie.* The duties that arise in the context of a share redemption or repurchase are better understood as the duties of fairness and disclosure imposed on the corporation as a result of the trustee relationship described in *Yeaman.* As noted above, officers, directors, and controlling shareholders may be held personally liable for participating in a breach of the corporation's legal duties to its shareholders. This line of cases represents a clear application of the quasi-fiduciary duties and liability based on the common-law cause of action for breach of trust. *Ritchie's* characterization of *Allen* as "addressing fraud claims relating to closely held company's purchase of minority shareholder interests"[912]—a fraud claim that existed only because of the fiduciary duty to make full disclosure—is at least an implicit acknowledgment of the existence of such duties.

It is important to note that the legal duty and liability for breach of that duty in these fraud cases arising in the context of a shareholder selling his stock to the corporation or those in control must be based on the fiduciary relationship between corporation and not on general tort law or statutory duties in securities fraud claims. If the fiduciary duty is removed, the result is different. In *Ward v. Succession of Freeman*,[913] the Fifth Circuit reversed a securities fraud judgment in favor of former minority shareholders of a Louisiana Coke-bottling corporation. A group of shareholders who together controlled twenty percent of the outstanding shares and who had control of the corporation's management, caused the corporation to make a series of tender offers to repurchase minority shares after attending a 1979 convention at which they learned that the Coca-Cola Corporation intended to initiate a restructuring program whereby it would "actively participate" in changes to the ownership of the affiliated bottling companies. In 1980, 1982, and 1983, the corporation made nonbinding offers to redeem minority shares at prices ranging from $321 per share to $850 per share. The plaintiffs sold their shares in the 1982 tender offer. In the 1982 tender offer document, the defendants mentioned to the possibility of a future reverse stock split (which would cash out a minority shareholder positions) but also represented at the company had no current plans for such a reverse split. As a result of the various tender offers, the defendants increase their share position from 20% to 80%. In 1984, the defendants sold the bottling company to Big Coke for $148 million. Thereafter, the plaintiffs sued, claiming that the series of tender offers were fraudulent and

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[910] *Id.* at 395; *see* Transeo S.A.R.L. v. Bessemer Venture Partners VI L.P., No. 11-CV-5331, 2013 WL 1285453, at *14 (S.D.N.Y. Mar. 29, 2013) (internal citations omitted) (stating majority shareholders owe fiduciary duties to minority shareholders but the duty is narrow and breached when majority shareholders exploit the minority shareholders).

[911] Ritchie v. Rupe, 443 S.W.3d 856, 888 n.56 (Tex. 2014).

[912] *Id.*

[913] 854 F.2d 780 (5th Cir. 1988).

constituted part of the defendants' plans to "squeeze out" and "freeze out" the minority shareholders. The case was tried to a jury, and the plaintiffs received a favorable judgment.[914]

With respect to the securities fraud claim, the Court held that there must be a misrepresentation or omission of a material fact.[915] The Court held that the plaintiffs' contention that the defendants had failed to disclose their "secret plan" or "true purpose" to "squeeze out or freeze out" the minority shareholders in order to sell to Big Coke did not state a claim for securities fraud. Federal securities laws do not provide a cause of action for breach of fiduciary duties unless there is an element of deception or fraudulent manipulation.[916] Therefore, the defendants' good faith or subjective motivation in entering into the transaction is not a "material fact."[917] The law governing securities fraud claims did not require disclosure of the mere possibility of a future sale to Big Coke because there was no offer, and negotiations did not begin until more than a year after the tender offer.[918] The breach of fiduciary duties claim was brought under Louisiana law. The Court held that the jury charge had applied the incorrect standard because the tender offers were not self-dealing transactions under Louisiana law because the benefit to the defendant shareholders from those transactions was no different from the benefit that devolved upon the corporation or all shareholders generally.[919] Therefore, the plaintiffs had no claim. However, had the case been decided under Texas law applying the duties recognized in *Yeaman*, it would seem that the result would have been different.

### *2. Constructive Fraud Cause of Action*

As discussed above, the corporation's duties to its shareholders include the duty to not to impair his ownership interests, to "to observe its trust for their benefit" and to preserve both the stock and its "fruits."[920] A transaction in which the corporation purchases an existing shareholder's stock and renders him no longer an owner falls squarely within the scope of this legal duty. Liability for common law fraud by non-disclosure, where there is a duty to disclose, applies "*even in an ordinary arms-length transaction in which no "fiduciary duties" exist* and only the ethics of the marketplace apply."[921] However, the cause of action asserted in the context of a fiduciary relationship is for constructive fraud,[922] which "is the breach of a legal

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914 *Id.* at 782–83.

915 *Id.* at 790.

916 *Id.* at 791 (citing Santa Fe Indus. v. Green, 430 U.S. 462 (1977)).

917 *Id.* (citing Biesenbach v. Guenther, 588 F.2d 400 (3d Cir.1978)) (determining that directors' failure to disclose "the true purpose behind" their activities to gain control of a corporation failed to state a claim); Vaughn v. Teledyne, Inc., 628 F.2d 1214 (9th Cir. 1980) (stating that undisclosed plan to increase control over corporation not fraud); Coronet Ins. Co. v. Seyfarth, 665 F. Supp. 661 (N.D. Ill. 1987) (holding that failure to disclose plan to entrench management not fraud). In part, these opinions are influenced by the fact that any person with even an elementary knowledge of the corporate structure would realize that an offer to repurchase stock would increase the ownership of the remaining shareholders and that the offer was probably made for that purpose. *See* Ala. Farm Bureau Mut. Cas. Co., Inc. v. Am. Fid. Life Ins. Co., 606 F.2d 602, 611 (5th Cir. 1979).

918 *Ward*, 854 F.2d at 792.

919 *Id.* at 794 (citing Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).

920 Yeaman v. Galveston City Co., 167 S.W. 710, 723 (Tex. 1914).

921 Chien v. Chen, 759 S.W.2d 484, 495 (Tex. App.—Austin 1988, no writ) (emphasis in original).

922 Miller v. Miller, 700 S.W.2d 941, 947 (Tex. App.—Dallas 1985, writ ref'd n.r.e.) ("Although breach of such a fiduciary duty is referred to in the above authorities as 'constructive fraud,' it is to be distinguished from other types

or equitable duty that the law declares fraudulent because it violates a fiduciary relationship."[923] Common-law fraud includes both "actual" and "constructive fraud."[924] "Breach of a fiduciary relationship can constitute fraud because the fiduciary relationship imputes higher duties, such as duties of good faith, candor, and full disclosure."[925] The elements of a breach of a fiduciary duty claim are (1) a fiduciary relationship between the plaintiff and defendant, (2) a breach by the defendant of her 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.[926] In a fiduciary relationship, constructive fraud "does not require an intent to defraud."[927] Nor is reliance an element. In *Miller v. Miller*, the purchase of a minority shareholder's stock was held invalid, notwithstanding jury findings that the defendant had acted in good faith, that his failure to disclose was not done with the intent to induce reliance, and that the plaintiff had not relied on the nondisclosure.[928]

The Texas cases have not fully examined the fiduciary duties that the trustee relationship imposes on a corporation in a transaction whereby it purchases the stock of an existing shareholder. However, in the context of a partnership, those duties are well-settled. The "law imputes to the relationship *additional and higher* duties and their breach may constitute a fraud as well."[929] These heightened duties, include the duty of "*full disclosure* respecting matters affecting the principal's interests and a general prohibition against the fiduciary's using the relationship to benefit his personal interest, except with the full knowledge and consent of the principal."[930] In *Johnson v. Peckham*, the Texas Supreme Court has held:

> [I]n a sale by one partner to another of his interest in the partnership, an absolute duty of full disclosure of all material facts and information to the buying partner is imposed upon the selling partner; such a sale, when challenged, will be sustained only when it is made in good faith, for a fair consideration and on a full and complete disclosure of all information as to value.[931]

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of 'constructive fraud' in which the entire burden rests on the party asserting it.").

[923] Hubbard v. Shankle, 138 S.W.3d 474, 483 (Tex. App.—Fort Worth 2004, pet. denied). *See also* Archer v. Griffith, 390 S.W.2d 735, 740 (Tex. 1964) ("Actual fraud usually involves dishonesty of purpose or intent to deceive, whereas constructive fraud is the breach of some legal or equitable duty which, irrespective of moral guilt, the law declares fraudulent because of its tendency to deceive others, to violate confidence, or to injure public interests.").

[924] *Chien*, 759 S.W.2d at 494–95.

[925] Flanary v. Mills, 150 S.W.3d 785, 795 (Tex. App.—Austin 2004, pet. denied).

[926] Jordan v. Lyles, 455 S.W.3d 785, 792 (Tex. App.—Tyler 2015, no pet.).

[927] *Hubbard*, 138 S.W.3d at 483.

[928] 700 S.W.2d 941, 948 (Tex. App.—Dallas 1985, writ ref'd n.r.e.).

[929] *Chien*, 759 S.W.2d at 495.

[930] *Id.*

[931] *See* Johnson v. Peckham, 120 S.W.2d 786 (Tex. 1938). *See also* Johnson v. Buck, 540 S.W.2d 393, 399 (Tex. Civ. App.—Corpus Christi 1976, writ ref'd n.r.e.) (requiring "in good faith, for a fair consideration and on a full and complete disclosure of all information as to value" in the purchase of a partnership interest); Gum v. Schaefer, 683 S.W.2d 803, 805 (Tex. App.—Corpus Christi 1984, no writ) ("A sale by one partner to another of his interest in the partnership will be sustained only when it is made in good faith, *for a fair consideration* and on a full and complete disclosure of all important information regarding value.") (emphasis in original).

Strained relations between the parties do not lessen the duty.[932] While the fiduciary duties that partners owe each other are admittedly broader than the duties that the corporation owes each shareholder,[933] there is no reasoned basis that the legal duties imposed on the corporation in the purchase of an ownership interest would be any different. In *Miller v. Miller*, the Dallas Court of Appeals cited *Johnson v. Peckham* as the "leading Texas case" on fiduciary duties in the context of the purchase of an ownership interest and applied the holding of that case to a purchase of minority shares.[934]

Furthermore, the burden of proving that the purchase of the minority shares was "made in good faith, for a fair consideration and on a full and complete disclosure of all information as to value" is squarely on the purchaser.[935] "*All* transactions between the fiduciary and his principal are presumptively fraudulent and void, which is merely to say that the burden lies on the fiduciary to establish the validity of any particular transaction in which he is involved."[936] Although the purchasing corporation must prove that it acted in good faith to sustain the transaction, good faith itself does not satisfy the defendant's burden of proof.[937] The fiduciary must also show that the transaction was "fair, honest, and equitable."[938]

### *3. Remedy*

The defrauded shareholder may elect to rescind the sale.[939] In *Miller v. Miller*, the court of appeals held that the existence of a fiduciary duty along with the defendant's failure to prove that the transaction was fair to the minority shareholder entitled the plaintiff to rescission as a matter of law, and reversed the trial court's judgment in favor of the defendant and rendered judgment for the plaintiff.[940]

Actual damages are recoverable for both actual fraud and constructive fraud.[941] The

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[932] *Johnson*, 120 S.W.2d at 788 ("If the existence of strained relations should be suffered to work an exception, then a designing fiduciary could easily bring about such relations to set the stage for a sharp bargain. There is no suggestion in this record that Peckham did that thing, but mischief would result more often from engrafting exceptions upon the general rule than from a strict adherence thereto.").

[933] *See, e.g.*, Bohatch v. Butler & Binion, 977 S.W.2d 543, 545 (Tex. 1998) (partners owe duties of loyalty to the joint concern and duties of utmost good faith, fairness, and honesty in dealing with each other in all matters pertaining to the partnership).

[934] 700 S.W.2d 941, 946–47 (Tex. App.—Dallas 1985, writ ref'd n.r.e.).

[935] *Johnson*, 120 S.W.2d at 787–88; *Miller*, 700 S.W.2d at 947.

[936] Chien v. Chen, 759 S.W.2d 484, 495 (Tex. App.—Austin 1988, no writ) (emphasis in original). *See also* Stephens Cty. Museum, Inc. v. Swenson, 517 S.W.2d 257, 260 (Tex. 1974); Archer v. Griffith, 390 S.W.2d 735, 740 (Tex. 1964); Estate of Townes v. Townes, 867 S.W.2d 414, 417 (Tex. App.—Houston [14th Dist.] 1993, writ denied). Unlike most presumptions, the presumption of unfairness shifts both the burden of producing evidence and the burden of persuasion to the defendant. *See* Sorrell v. Elsey, 748 S.W.2d 584, 585 (Tex. App—San Antonio 1988, writ denied); Moore v. Tex. Bank & Trust Co., 576 S.W.2d 691, 695 (Tex. App.—Eastland 1979), *rev'd on other grounds*, 595 S.W.2d 502 (Tex. 1980).

[937] *Miller*, 700 S.W.2d at 947. *Accord Archer,* 390 S.W.2d at 740; Cartwright v. Minton, 318 S.W.2d 449, 452–53 (Tex. Civ. App.—Eastland 1958, writ ref'd n.r.e.) (quoting Murphy v. Cartwright, 202 F.2d 71, 73 (5th Cir.1953)).

[938] *Archer,* 390 S.W.2d at 740.

[939] Italian Cowboy Partners v. Prudential Ins., 341 S.W.3d 323, 344 (Tex. 2011).

[940] 700 S.W.2d at 952.

[941] *See* Speed v. Eluma Intern., Inc., 757 S.W.2d 794, 798 (Tex. App.—Dallas 1988, writ denied).

plaintiff may recover his out-of-pocket damages—the difference between the value of what the defrauded party parted with and the value it actually received[942]—or benefit-of-the-bargain damages—the difference between the value as represented and the value as received.[943] As most cases would involve the failure to disclose information indicating a higher value of the shares being sold or payment on unfairly low consideration, the out-of-pocket measure would be the usual theory of damages. A difficulty arises when the undisclosed information is an opportunity that does not materialize for a period of time. In *Allen v. Devon Energy Holdings, L.L.C.*, the company redeemed the minority owner's interest for an agreed price but failed to disclose recent technological advances that made the company potentially much more valuable. One and a half years after the redemption, the majority (now sole) owner sold the company for twenty times the valuation used in the redemption.[944] The defendants argued on appeal that the plaintiff had no actual damages as a matter of law because the price eventually received for the stock could not constitute actual damages, as the amount was not knowable at the time of the fraudulent transaction and such an award would be based on speculation.[945] The defendants relied on the Texas Supreme Court's decision in *Miga v. Jensen*, in which the Court reversed an award of damages for breach of an option contract to sell shares based on the increased value of the shares at the time of trial: "But the rule in Texas has long been that contract damages are measured at the time of breach, and not by the bargained-for goods' market gain as of the time of trial."[946] The court of appeals rejected this authority as inapplicable in a fraud case, noting that "[u]nlike a contract case, the law favors granting the benefit of the delay to the victim of the fraud."[947] Because *Allen* was an appeal of a summary judgment in favor of the defendants, the plaintiff had not yet made his damages record. The court of appeals conceded that there might very well be issues with speculative damages evidence, but concluded that the defendants had not established that there were no damages as a matter of law.[948]

Significantly, however, the *Allen* court held that, even if the full benefit received by the defendants as a result of the fraud could not be recovered as actual damages, that amount certainly could be recovered through the equitable remedy of disgorgement.[949] Additionally,

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[942] Aquaplex, Inc. v. Rancho La Valencia, Inc., 297 S.W.3d 768, 775 (Tex. 2009).

[943] Formosa Plastics Corp. U.S.A. v. Presidio Eng'rs & Contractors, Inc., 960 S.W.2d 41, 50 (Tex. 1998); Baylor Univ. v. Sonnichsen, 221 S.W.3d 632, 636 (Tex. 2007).

[944] 367 S.W.3d 355, 367 (Tex. App.—Houston [1st Dist.] 2012, pet. granted).

[945] *Id*. at 406.

[946] 96 S.W.3d 207, 214 (Tex. 2002).

[947] 367 S.W.3d at 409 n.77. The court relied on the holding in Janigan v. Taylor, 344 F.2d 781, 786 (1st Cir. 1965):

> [I]f the property is not bought from, but sold to the fraudulent party, future accretions not foreseeable at the time of the transfer even on the true facts, and hence speculative, are subject to another factor, viz., that they accrued to the fraudulent party. It may, as in the case at bar, be entirely speculative whether, had plaintiffs not sold, the series of fortunate occurrences would have happened in the same way, and to their same profit. However, there can be no speculation but that the defendant actually made the profit and, once it is found that he acquired the property by fraud, that the profit was the proximate consequence of the fraud, whether foreseeable or not. It is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them.

[948] 367 S.W.3d at 409–10.

[949] *Id*. at 406. *See* Robertson v. ADJ P'ship, Ltd., 204 S.W.3d 484, 494 (Tex. App.—Beaumont 2006, pet. denied) (stating that "disgorgement of profits has long been recognized as an appropriate remedy for fraud"); *see also*

the equitable doctrines of unjust enrichment and quasi-contract "allow for recovery of damages to prevent a party from obtaining a benefit from another by fraud, duress, unjust enrichment, or because of an undue advantage."[950]

### C. Accounting

Among the various "squeeze-out" or "freeze-out" tactics that the Texas Supreme Court specifically noted that controlling shareholders commonly use "to deprive minority shareholders of benefits, to misappropriate those benefits for themselves, or to induce minority shareholders to relinquish their ownership for less than it is otherwise worth," for which "Texas law should ensure that remedies exist to appropriately address such harm when the underlying actions are wrongful," is the denial of access to corporate books and records.[951]

> A common complaint of those alleging shareholder oppression is the denial of access to the corporation's books and records. Our Legislature has expressly protected a corporate shareholder's right to examine corporate records, provided penalties for a violation of those rights, and identified applicable defenses in an action to enforce those rights. . . . These statutory rights and remedies adequately protect a minority shareholder's access to corporate records.[952]

Yet the statutory right of inspection is only a part of the duties imposed on the corporation relating to corporate information. The inspection statute only gives the shareholder the right to inspect existing records. It places no duties to create and report information or to create and maintain accurate and meaningful records accounting for its management of the shareholders' property.

The Business Organizations Code requires that "[e]ach filing entity shall keep: (1) books and records of accounts."[953] These records are to be made available to shareholders[954] and directors,[955] and the corporation must provide annual statements for the last fiscal year "that contain in reasonable detail the corporation's assets and liabilities and the results of the

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ERI Consulting Eng'rs, Inc. v. Swinnea, 318 S.W.3d 867, 874 (Tex. 2010) (noting that disgorgement and fee forfeiture are equitable remedies intended to prevent abuses of trust, "regardless of proof of actual damages"); Bonanza Rests. v. Uncle Pete's, Inc., 757 S.W.2d 445, 448 (Tex. App.—Dallas 1988, writ denied) (holding that jury's answer of $0 in damages caused by fraud did not preclude claimant from recovering rescission of franchise agreement induced by defendant's fraud); Burrow v. Arce, 997 S.W.2d 229, 237–45 (Tex. 1999) (holding that trial court erred in granting summary judgment against breach of fiduciary duty claimants on ground that there were no actual damages).

950 Hubbard v. Shankle, 138 S.W.3d 474, 487 (Tex. App.—Fort Worth 2004, pet. denied). *See* Fortune Prod. Co., v. Conoco, Inc., 52 S.W.3d 671, 684 (Tex. 2000); *see also* Heldenfels Bros., Inc. v. City of Corpus Christi, 832 S.W.2d 39, 41 (Tex. 1992).

951 Ritchie v. Rupe, 443 S.W.3d 856, 879 (Tex. 2014).

952 *Id.* at 882 (citing TEX. BUS. ORGS. CODE ANN. § 21.218 (West 2006) (examination of records); *id.* § 21.219 (annual and interim statements of corporation); *id.* § 21.220 (penalty for failure to prepare voting list); *id.* § 21.222 (penalty for refusal to permit examination); *id.* § 21.354 (inspection of voting list); *id.* § 21.372 (shareholder meeting list)).

953 BUS. ORGS. § 3.151.

954 *Id.* §§ 3.153, 21.218.

955 *Id.* § 3.152.

corporation's operations" to a shareholder upon written request.[956] Unlike the duty to allow shareholder inspection, there is no statutory remedy for the failure to keep records and no express requirement to keep complete and accurate records. While not addressed specifically by the Code or in any Texas case, logic would dictate that the duty to keep records of account and provide them to owners and directors necessarily implies a duty to maintain financial records that are accurate, complete, and meaningful.[957] How else would the corporation be able to comply with its statutory duty to provide annual statements that contain in reasonable detail the corporation's assets and liabilities and the results of the corporation's operations?[958] Although logically implied by the corporation's statutory obligation, these duties are expressly imposed by trust law. A fundamental duty of a trustee is to "maintain a complete and accurate accounting of the administration of the trust."[959] One Texas court has noted that the president and general manager of a corporation, "in control of the business and books of the corporation," acts as a "trustee for the corporation and for the other stockholders."[960] Courts in other jurisdictions have held that the accounting duties of a trustee, by analogy, impose a duty on corporate officers and directors to account for corporate finances.[961] The Texas Supreme Court in *Yeaman*, expressly recognized the shareholder's right to the remedy of an accounting based on the corporation's trust duties.[962]

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[956] *Id.* § 21.219.

[957] *See* Dunn v. Acme Auto & Garage Co., 169 N.W. 297, 301 (Wis. 1918) ("The statutory right of the stockholder to examine the books of the corporation imposes upon the corporation not only the duty of keeping such books open for inspection at all reasonable times, but also the duty of keeping its stock subscriptions and accounts in such form that they may be examined and the condition of the corporate affairs ascertained therefrom; otherwise the right of inspection is a barren legal right and of no value.").

[958] *See* Saks v. Gamble, 154 A.2d 767, 769 (Del. Ch. 1958) (noting the "duty required of the corporate officers to keep complete and accurate books of account"); Griffin v. Cambridge Const. Co., 236 So.2d 539, 541 (La. Ct. App. 1970) (duty of "proper bookkeeping"); *Dunn*, 169 N.W. at 301 ("Those who claim the right and authority to manage and control the money and property of others ought to show themselves competent to keep an honest and fairly accurate account of their transactions."); 5A FLETCHER CYC. CORP. § 2187 ("Most jurisdictions impose an obligation on the corporation to keep correct and complete books and records.").

[959] Faulkner v. Bost, 137 S.W.3d 254, 259 (Tex. App.—Tyler 2004, no pet.). *See also* Beaty v. Bales, 677 S.W.2d 750, 754 (Tex. App.—San Antonio 1984, writ ref'd n.r.e.) ("The trustee is required to keep full, accurate, and orderly records concerning the status of the trust estate and of all acts performed thereunder."); Corpus Christi Bank & Trust v. Roberts, 587 S.W.2d 173, 181 (Tex. Civ. App.—Corpus Christi 1979) *aff'd,* 597 S.W.2d 752 (Tex. 1980) ("One of the primary duties of a trustee is to keep full, accurate and orderly records concerning the status of the trust estate and of all acts performed thereunder.").

[960] Conrads v. Kasch, 26 S.W.2d 732, 735 (Tex. Civ. App.—Austin) *writ denied*, 31 S.W.2d 630 (Tex. 1930).

[961] *See, e.g.*, Smith v. Moore, 199 F. 689, 697 (9th Cir. 1912) (Corporate president's "position was that of trustee, and it was incumbent upon him to see that proper books of account were kept."); Grand Amusement Co. v. Palladium Amusement Co., 287 S.W. 438, 441 (Mo. 1926) ("It is unquestionably true that the officers and directors of a corporation are, in a sense, trustees, and that, as such, it is their duty to keep correct accounts and to be able to make a full and correct showing of the corporation's receipts and expenditures."); Lancaster v. Johnson, 167 So. 435, 437 (La. 1936) (Corporate officer has a "duty to keep and preserve" an "honest and accurate account of his transactions."); Trieweiler v. Sears, 689 N.W.2d 807, 840 (Neb. 2004) (Corporate officer "in control of the books . . . in the position of a trustee and must make a proper accounting."); Anderson v. Clemens Mobile Homes, Inc., 333 N.W.2d 900, 904 (Neb. 1983) (same).

[962] Yeaman v. Galveston City Co., 167 S.W. 710, 724 (Tex. 1914) ("plaintiffs are entitled to an accounting from the corporation"). *See also* Trieweiler v. Sears, 689 N.W.2d 807, 840 (Neb. 2004) ("Although the burden of proof is ordinarily upon the party seeking an accounting to sustain the accounting, when another person is in control of the books and has managed the business, that other person is in the position of a trustee and must make a proper

"A suit for an accounting is generally founded in equity."[963] "The granting of an accounting is within the discretion of the trial court."[964] To be entitled to an accounting, the plaintiff must show a fiduciary relationship with the defendant[965] and the need for the procedure—typically that the failure to keep accurate and complete records will render the task of uncovering the defendant's wrongdoing so complex that adequate relief cannot be obtained at law.[966] However, the remedy of an accounting may require the creation of accurate financial records where none exists, not merely grant the plaintiff access to existing records. If the minority shareholder can obtain the needed information through a statutory inspection demand or through ordinary discovery in a lawsuit, then the court will not order an accounting.[967]

The accounting remedy will be useful to minority shareholders in cases where the corporation has either failed to keep adequate accounting records or where the books have been "juggled"[968] to hide theft. In situations where the controlling shareholder, through his control of the books, has prepared to defend his gross misappropriation of funds and disproportionate distributions by making the misconduct difficult to prove, an accounting remedy might be particularly helpful as a step preceding a derivative suit for damages. An order requiring the corporation and the controlling shareholder to prepare and present accurate financial records, properly accounting for all corporate receipts, expenditures, assets, and liabilities can shift some of the enormous burden of unscrambling the financial eggs onto the corporation and majority shareholder, rather than on the plaintiff minority shareholder. An accounting is a flexible remedy that may apply in a variety of scenarios.[969] Also useful is the trial court's ability to appoint an independent auditor to oversee or to perform the accounting.[970] The audit procedure provides the court the power to appoint an auditor "[w]hen an investigation of accounts . . . appears necessary for the purpose of justice between the parties to any suit," and requires the auditor to prepare a report, verified by affidavit "that he has carefully examined the state of the account between the parties, and that his report contains

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accounting. Here, the evidence establishes that Campagna had control of the books of the corporation and managed the business and that Sears had a duty to examine Campagna's conduct; it was the appellants' burden to account for the corporation's revenues and the disposition of its assets.").

963 Palmetto Lumber Co. v. Gibbs, 80 S.W.2d 742, 748 (Tex. 1935); Garcia v. Garza, 311 S.W.3d 28, 40 (Tex. App.—San Antonio 2010, pet. denied); Sw. Livestock & Trucking Co. v. Dooley, 884 S.W.2d 805, 809 (Tex. App.—San Antonio 1994, writ denied).

964 *Sw. Livestock*, 884 S.W.2d at 809; Gifford v. Gabbard, 305 S.W.2d 668, 672 (Tex. Civ. App.—El Paso 1957, no writ).

965 *See* T.F.W. Mgmt., Inc. v. Westwood Shores Prop. Owners Ass'n, 79 S.W.3d 712, 717 (Tex. App.—Houston [14th Dist.] 2002, pet. denied); Hunt Oil Co. v. Moore, 656 S.W.2d 634, 642 (Tex. App.—Tyler 1984 writ ref'd n.r.e.); Hedley v. duPont, 580 S.W.2d 662, 666 (Tex. Civ. App.—Houston [14th Dist.] 1979, writ ref'd n.r.e.); O'Connor v. O'Connor, 320 S.W.2d 384 (Tex. Civ. App.—Dallas 1959, writ dism'd).

966 Richardson v. First Nat'l Life Ins. Co., 419 S.W.2d 836, 838 (Tex. 1967); Michael v. Dyke, 41 S.W.3d 746, 754 (Tex. App.—Corpus Christi 2001, no pet.); Hutchings v. Chevron U.S.A., Inc., 862 S.W.2d 752, 762 (Tex. App.—El Paso 1993, writ denied); T.F.W. Mgmt., Inc. v. Westwood Shores Prop. Owners Assoc., 79 S.W.3d 712, 717 (Tex. App.—Houston [14th Dist.] 2002, pet. denied).

967 *T.F.W. Mgmt., Inc.*, 79 S.W.3d at 717–18 ("When a party can obtain adequate relief at law through the use of standard discovery procedures, such as requests for production and interrogatories, a trial court does not err in not ordering an accounting.").

968 Patton v. Nicholas, 279 S.W.2d 848, 853 (Tex. 1955).

969 *See, e.g.*, *Gifford,* 305 S.W.2d at 672; *Sw. Livestock*, 884 S.W.2d at 810.

970 TEX. R. CIV. P. 172 (West 1988).

a true statement thereof, so far as the same has come within his knowledge."[971] The parties are given a 30-day deadline to file exceptions to the report, and "the court shall award reasonable compensation to such auditor to be taxed as costs of suit."[972]

The duty to account is a duty that the corporation, as trustee, owes to each shareholder and should be available as an individual remedy against the corporation, as was the case in *Yeaman*. However, similar to *Ritchie*'s treatment of the *Patton* claim for suppression of dividends, there may be policy reasons for requiring the claim be brought in a derivative action, because the benefit would be conferred on all shareholders equally and the responsibility for complying with the order to perform the accounting will fall on the corporation's management.

## D. Dividend Actions

Among the various "squeeze-out" or "freeze-out" tactics that the Texas Supreme Court specifically noted in *Ritchie* for which "Texas law should ensure that remedies exist to appropriately address such harm when the underlying actions are wrongful," is withholding payment of, or declining to declare, dividends.[973] The Supreme Court recognized that a common complaint by those alleging shareholder oppression relates to the corporation's declaration of dividends, including the failure to declare dividends or the failure to declare higher dividends.[974]

The right to dividends is clearly a legal right that the individual shareholder has as against the corporation. The Texas Supreme Court pointed out in *Ritchie* that "that shareholders already have a right to receive payment of a declared dividend in accordance with the terms of the shares and the corporation's certificate of formation, and they can enforce that right as a debt against the corporation."[975] The corporation's fiduciary duties as trustee also encompass the shareholder's right to dividends. As the Supreme Court held in *Yeaman*, the corporation, as trustee, has a fiduciary duty to preserve both the shareholder's stock and "its fruits."[976] "Though considered a debt, as a shareholder's dividends are payable by the corporation only on demand, its holding of them until the demand is in the nature of a trustee relation."[977]

### *1. Suppression of Dividends Claim*

"Texas law does not require a corporation to issue dividends. It is within the discretion of the board of directors whether a dividend will issue."[978] Courts tend to show extreme

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971 *Id.*

972 *Id.*

973 Ritchie v. Rupe, 443 S.W.3d 856, 879 (Tex. 2014).

974 *Id.* at 882.

975 *Id.* at 882–83. *See also* Keller v. Keller, 141 S.W.2d 308, 311 (Tex. 1940) ("When dividends are declared, the corporation becomes indebted to the stockholders for the amounts of their respective shares."); Cavitt v. Amsler, 242 S.W. 246, 247 (Tex. Civ. App.—Austin 1922, writ dism'd w.o.j.) ("[W]hen a dividend is declared, it becomes a debt owing by the corporation to the stockholders").

976 Yeaman v. Galveston City Co., 167 S.W. 710, 723 (Tex. 1914).

977 *Id.* at 724.

978 ARGO Data Res. Corp. v. Shagrithaya, 380 S.W.3d 249, 270 (Tex. App.—Dallas 2012, pet. denied). *See*

deference as to the decision to declare dividends or to retain earnings.[979] Nevertheless, Texas law has long held that the "chief value of corporate stock is its right to receive dividends. So important is this right that courts of equity will, in a proper case, compel a payment of dividends."[980] The right of a shareholder to enforce the payment of dividends "does not arise from any actual contract between the corporation and its stockholders, but rather from the nature of the organization, and the relation of the stockholders to the corporation and its property."[981] That relation between stockholder and corporation is that of trustee to beneficiary.[982] Therefore, the common law cause of action for suppression of dividends recognized and developed in *Patton* and *Morrison* was for "breach of trust."[983]

Neither *Patton* nor *Morrison* state the elements for a breach of trust claim. Both characterize the wrong-doing as "malicious suppression of dividends."[984] In *Patton*, the key fact seems to have been the majority shareholder's wrongful intent to withhold dividends for the express purpose of harming the minority and perhaps acquiring their shares for an unfairly low price.[985] *Morrison* involved the manipulation of the corporation's finances to reduce earnings available for distribution, as well as unfairly low distributions, but both with the wrongful intent of harming the minority.[986] Such an intent would breach the corporation's duties as trustee to the shareholders of acting impartially and of "not attempting to impair [their] interest."[987]

### *(a) Stockpiling Cash*

The fact situation giving rise to a claim as contemplated by *Ritchie* would be the

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TEX. BUS. ORGS. CODE ANN. § 21.302 (West 2012). *See also Ritchie*, 443 S.W.3d at 883 (citing BUS. ORGS. §§ 21.302–.303; 21.310–.313).

[979] *See* Cleaver v. Cleaver, 935 S.W.2d 491, 495 (Tex. App.—Tyler 1996, no writ) ("It is established that corporate management may invest company earnings in corporate assets rather than distributing those earnings to shareholders."); Fain v. Fain, 93 S.W.2d 1226, 1228–29 (Tex. Civ. App.—Fort Worth 1936, writ dism'd) ("It is a settled rule that the legal title to stock in a corporation is not affected by the acquisition of additional assets by the corporation, and that, in the absence of fraud, the directors of a corporation may, in their discretion, invest its earnings in such assets instead of distributing them to the shareholders. Also that enhanced value of the assets inure to the shareholders."); Bryan v. Sturgis Nat'l Bank, 90 S.W. 704, 705 (Tex. Civ. App. 1905, writ ref'd) ("It is also well settled that the declaration of dividends rests in the discretion of the directors or other governing body of the corporation, and that such discretion will not, in the absence of fraud, be controlled by the courts."). *See also* Lich v. U.S. Rubber Co., 39 F. Supp. 675, 683 (D.N.J.), *aff'd*, 123 F.2d 145 (3d Cir. 1941) ("The directors are charged with the management of the corporate business, and, in the absence of fraud or bad faith, their authority must be regarded as absolute. Questions of management and policy must be left to their honest judgment and discretion.").

[980] Moroney v. Moroney, 286 S.W. 167, 169 (Tex. Comm'n App. 1926, judgm't affirmed).

[981] *Id.*

[982] *Yeaman*, 167 S.W. at 724 ("There can be no substantial difference between the trusteeship of a corporation as it relates to the stock of a shareholder and its duty to him in respect to the profits or dividends upon his stock.").

[983] Patton v. Nicholas, 279 S.W.2d 848, 854 (Tex. 1955). *See* Morrison v. St. Anthony Hotel, 295 S.W.2d 246, 252 (Tex. Civ. App.—San Antonio 1956, writ ref'd n.r.e.).

[984] *Morrison*, 295 S.W.2d at 252.

[985] *Patton*, 279 S.W.2d at 854.

[986] *Morrison*, 295 S.W.2d at 252.

[987] *Yeaman*, 167 S.W. at 723.

accumulation of retained earnings without declaration of dividends, or "stockpiling" cash.[988] When the cash is in the company and available for distribution, minority shareholders would have three legal theories to compel a distribution. First, would be an action for a mandatory injunction compelling a distribution as was provided in *Patton*. The *Ritchie* Court seems to have accepted the cause of action articulated by *Patton* but redefined it as a derivative action.[989] Although we have argued that *Ritchie* misconstrues the procedural posture of *Patton*, requiring the claim to be pursued derivatively in the fact situation presented in *Patton* makes practical sense. When the money is just sitting in the company, the suppression decision affects all shareholders the same, as does the benefit of the injunctive relief to pay out the stockpiled funds. Some other jurisdictions have taken the same approach.[990] In order to obtain relief from stockpiling, the plaintiff would have to overcome the business judgment rule by showing that the decision to stockpile cash rather than declare dividends was made for an "improper purpose."[991] The *Patton* Court indicated that the plaintiff was required to prove a "malicious purpose."[992] The *Ritchie* opinion seems to have considerably lowered the plaintiff's burden of proof, requiring proof only that the directors made their dividend decision without dedicating their "uncorrupted business judgment for the sole benefit of the corporation."[993] Proof that the purpose of the dividend decision was to personally benefit the controlling shareholder would certainly satisfy the plaintiff's burden.[994] However, even non-self-interested purposes that did not solely benefit the corporation would also seem to satisfy the burden as described in *Ritchie*. In fact, a plaintiff might be able to satisfy his burden by proof merely of non-feasance—that the board wasn't doing its job, was refusing to make a decision that it was charged with making. *Ritchie*'s repeated description of the board's duty certainly implies an affirmative duty to exercise business judgment for the benefit of the corporation.[995] Many courts have held that the business judgment rule does not shield the failure to make decisions, when that failure involves an abdication of the director's duties.[996]

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[988] *See* ARGO Data Res. Corp. v. Shagrithaya, 380 S.W.3d 249, 268 (Tex. App.—Dallas 2012, pet. denied).

[989] *See* Ritchie v. Rupe*,* 443 S.W.3d 856, 883 (Tex. 2014).

[990] *See, e.g.*, Powell v. Bernstein, 262 A.D.2d 221, 222 (N.Y. App. Div. 1999) ("Plaintiffs' claims to compel the declaration of a dividend and restitution of allegedly excessive salaries are derivative nature.").

[991] *Ritchie*, 443 S.W.3d at 884 ("when a corporate director violates the duty to act solely for the benefit of the corporation and refuses to declare dividends for some other, improper purpose, the director breaches fiduciary duties to the corporation, and the minority shareholders are entitled to relief, either directly to the corporation or through a derivative action").

[992] Patton v. Nicholas, 279 S.W.2d 848, 853 (Tex. 1955) ("malicious purpose of, and with the actual result of, preventing dividends").

[993] *Ritchie*, 443 S.W.3d at 883 (quoting Int'l Bankers Life Ins. Co. v. Holloway, 368 S.W.2d 567, 576–77 (Tex. 1963)).

[994] *Id.* at 884 n.51 ("*Patton* is thus contrary to the dissent's assertion that majority shareholders can simply refuse to declare dividends for their own personal benefit rather than in the best interest of the corporation.").

[995] *Id*. at 876 n.27 ("This Court has recognized a fiduciary duty owed by corporate officers and directors to the corporation [that] *requires* them to exercise their "uncorrupted business judgment for the sole benefit of the corporation," quoting *Holloway,* 368 S.W.2d at 576–77 (Tex.1963) (emphasis added)).

[996] *See* Resol. Trust Corp. v. Norris, 830 F. Supp. 351, 357 (S.D. Tex. 1993) ("The business judgment rule does not protect defendants who "abdicated their responsibilities as directors"). *See also* F.D.I.C. v. Benson, 867 F. Supp. 512 (S.D. Tex. 1994) (to avoid protective shield of Texas business judgment rule, plaintiff must show that acts of directors and officers were ultra vires or tainted by fraud, or a complete abdication of duty); RTC v. Acton, 844 F. Supp. 307 (N.D. Tex. 1994) (in general, Texas business judgment rule restricts liability of officers and directors for liability for acts of gross negligence, which may include complete abdication of their responsibilities); F.D.I.C. v.

A second alternative legal theory would be available where the stockpile of cash has been segregated, perhaps in a special investment fund separate from the corporation's other working capital. In that case, a minority shareholder could claim that there had been a constructive declaration and demand payment. Texas courts have held that

> it is not essential to the right to receive a dividend that there should have been a formal declaration of a dividend, but where the corporation sets apart a fund for distribution to its stockholders to such extent as to become segregated from the property of the corporation, such property henceforth becomes, equitably, the stockholders' property. . . . In other words, where there has been such a segregation of the corporate funds, and such a dedication to the stockholders, the assets thus segregated cease to belong to the corporation, but do belong to the stockholders individually.[997]

The minority shareholder's claim would be an individual claim against the corporation for the payment of debt. [998]

Finally, individual minority shareholders would have a breach of trust claim as described above to recover unpaid dividends as damages.[999] However, that remedy would be available only where the minority shareholder had no other adequate remedy, such as through a derivative action, which was the situation in *Morrison*.

*(b) Manipulation*

A more difficult situation arises when dividends are suppressed, not because the cash is being stockpiled, but because the corporation's finances are being manipulated to eliminate the cash. That was the situation in *Morrison*. Where the money that would otherwise be available for distribution to the shareholders is being siphoned off to the majority through excessive salaries and bonuses, personal expenses, misappropriation, and other self-dealing transactions, then the manipulation constitutes a breach of fiduciary duties to the corporation,[1000] and

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Brown, 812 F. Supp. 722 (S.D. Tex. 1992) (Texas business judgment rule does not bar claims for gross negligence against disinterested corporate directors; Texas business judgment rule does not protect director if director abdicated his responsibility and failed to exercise any judgment, rule necessarily presumes that directors exercise their judgment); Rabkin v. Philip A. Hunt Chemical Corp., No. 164,1990, 1987 WL 28436 (Del. Ch. Dec. 17, 1987) (directors who "abdicate their managerial responsibilities" are not entitled to the business judgment rule's protection from liability.).

[997] Moroney v. Moroney, 286 S.W. 167, 169–70 (Tex. Comm'n App. 1926, judgm't affirmed).

[998] *Ritchie*, 443 S.W.3d at 882–83; Keller v. Keller, 141 S.W.2d 308, 311 (Tex. 1940); Cavitt v. Amsler, 242 S.W. 246, 247 (Tex. Civ. App.—Austin 1922, writ dism'd w.o.j.).

[999] Morrison v. St. Anthony Hotel, 295 S.W.2d 246, 252 (Tex. Civ. App.—San Antonio 1956, writ ref'd n.r.e.).

[1000] *Ritchie*, 443 S.W.3d at 887 ("the duty of loyalty that officers and directors owe to the corporation specifically prohibits them from misapplying corporate assets for their personal gain or wrongfully diverting corporate opportunities to themselves"); *Holloway,* 368 S.W.2d at 576 ("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."); Dunagan v. Bushey, 263 S.W.2d 148, 152 (Tex. 1953) ("The directors of a corporation stand in a fiduciary relationship to the corporation and its stockholders, and they are without authority to act as such in a matter in which a director's interest is adverse to that of the corporation. The directors are not permitted to appropriate the property of

minority shareholders have the remedy of a derivative claim to recover the stolen funds.[1001] In a closely-held corporation, the court has the power to treat such a derivative claim as a direct claim and award the minority shareholder his proportional share of the misappropriated funds directly,[1002] which would place the plaintiff in the same position as he would have been in had the dividends been declared. In situations like *Morrison*, where the derivative claim remedy is not available, a shareholder should be able to bring an individual breach of trust claim for damages based on the corporation's violation of its duty of impartiality and the impairment of the minority shareholder's right to proportionately share in profits. If the misappropriations are part of a much larger scheme to effectively eliminate the minority shareholder's ownership interest, such that damages for the misappropriation would not make the plaintiff whole, then the minority shareholder should have a breach of trust claim for a buy-out.

### *(c) Re-examining* ARGO Data Res. Corp. v. Shagrithaya

At the time the Supreme Court decided *Ritchie*, two other cases out of the Dallas Court of Appeals were also pending review in the Supreme Court: *Cardiac Perfusion Services, Inc. v. Hughes*,[1003] where the minority shareholder prevailed in the court of appeals and which the Supreme Court reversed and remanded with a per curiam opinion,[1004] and *ARGO Data Res. Corp. v. Shagrithaya*,[1005] where the minority shareholder lost in the court of appeals and which the Supreme Court denied the petition for review after the case was fully briefed. *ARGO* was a case tried under the shareholder oppression doctrine in which the central issue concerned suppression of dividends. The case was tried to a jury, which found in favor of the minority shareholder, and the trial court rendered judgment in favor of the plaintiff, including an injunction to pay out an $85 million dividend.[1006] It is a pity that the Supreme Court disposed of *ARGO* as it did, because the reasoning of the court of appeals was clearly inconsistent with the holdings in *Ritchie*, and while the court of appeals' reversal was no doubt correct in light of *Ritchie*, the court of appeals' opinion plainly demonstrates that the record would have supported claims that the *Ritchie* opinion indicated were valid and would likely have been successful in a new trial based on the correct legal theories.

Max Martin and Balkrishna Shagrithaya met and became friends while working at Electronic Data Systems in Wisconsin. In 1980, Martin approached Shagrithaya about starting a software business together. Shagrithaya agreed to join the venture, and the men co-founded ARGO Data Resource Corporation, a business providing software and related services to the retail financial services industry.[1007] Shagrithaya developed the technology, and Martin ran the business side. Martin received 53% of the stock, and Shagrithaya 47%; both were directors and had an equal vote, but agreed that Martin had the power to appoint a third director in the event

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the corporation to their benefit, nor should they permit others to do so.").

[1001] *Ritchie*, 443 S.W.3d at 887 ("Like most of the actions we have already discussed, these types of actions may be redressed through a derivative action, or through a direct action brought by the corporation, for breach of fiduciary duty.").

[1002] TEX. BUS. ORGS. CODE ANN. § 21.563 (c) (West 2013).

[1003] 380 S.W.3d 198 (Tex. App.—Dallas 2012), *aff'd in part, rev'd in part*, 436 S.W.3d 790 (Tex. 2014).

[1004] *Cardiac Perfusion Services, Inc.*, 436 S.W.3d 790.

[1005] 380 S.W.3d 249 (Tex. App.—Dallas 2012, pet. denied).

[1006] *Id*. at 257.

[1007] *Id*. at 257–58.

of a deadlock.[1008] Both agreed to retain earnings while building the company, and no dividends were paid for more than twenty years.[1009] The company's capital grew from "$1000 in 1980 to $152 million in 2008."[1010] During this time, both men paid themselves equal salaries each year, which increased and topped out at $1 million each.[1011]

The relationship between the parties became strained, beginning in the early 2000s.[1012] In 2005, the IRS audited ARGO and imposed a penalty for excessive retained earnings. ARGO filed an ultimately successful protest to the penalty claiming that it was not accumulating "earnings and profits beyond the reasonable needs of its business."[1013] Among the business needs for working capital specified in the protest, was that the anticipated redemption of Shagrithaya's shares, which was anticipated in 2005. Additionally, the letter stated that

> '[ARGO's] "executive management had concluded prior to June 30, 2005, that Mr. Shagrithaya's minority stock position would likely have to be redeemed to protect the stability of [ARGO's] business and to avoid impending management and shareholder conflicts that [ARGO's] executive management believed were almost certain to occur.'[1014]

The letter further stated that, "[t]he implementation of the phase-out of Mr. Shagrithaya began in earnest in 2003 with a restructuring of [ARGO's] operational structure."[1015] At the time of the protest letter, Martin and Shagrithaya had not yet discussed a buy-out, and Shagrithaya was completely unaware of the on-going "phase-out" of his ownership, including the need to stockpile cash to pay for it. Neither the tax penalty, nor the protest, nor the contents of the protest letter were disclosed to Shagrithaya.[1016]

In 2006, Martin unilaterally cut Shagrithaya's salary from $1 million to $300,000, while keeping his own $1 million salary unchanged.[1017] Thereafter, the two shareholders held discussions, off and on, over the next two years, regarding payment of dividends (which Shagrithaya now advocated), salary, having the company appraised, and buying out Shagrithaya's interest.[1018] Martin and Shagrithaya never came to an agreement on any of the matters, particularly the price to be paid for Shagrithaya's shares. Ultimately, as negotiations went nowhere, Shagrithaya lost interest in a buy-out and began to push for a sizable dividend of $85 million from the company's $152 million stockpile of cash.[1019] Martin and the third

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[1008] *Id*. at 258.
[1009] *Id*.
[1010] *Id*.
[1011] *Id*.
[1012] *Id*. at 259.
[1013] *Id.* at 260.
[1014] *Id*.
[1015] *Id*.
[1016] *Id*.
[1017] *Id*. at 259.
[1018] *Id*. at 259–61.
[1019] *Id*. at 262.

board member he had appointed ultimately approved a $25 million dividend.[1020]

The case was tried to a jury on theories of shareholder oppression, malicious suppression of dividends, fraud, and various derivative claims; the jury found for the plaintiff on every issue submitted.[1021] The trial court entered a judgment for the plaintiff and awarded damages and attorney's fees on a number of theories, but most significantly ordered an immediate dividend in the amount of $85 million—$20 million more than the jury had found should be issued.[1022] The Dallas Court of Appeals reversed and rendered on all theories.[1023] While several issues are raised by the court of appeals' decision, of central interest to this discussion is its treatment of the dividend award and the factual findings supporting it.

The plaintiff had made the claim for dividends based on shareholder oppression and malicious suppression of dividends as separate causes of action, and had received findings in support of both. The court of appeals held that malicious suppression of dividends was not a separate cause of action, but was merely one form of shareholder oppression, and the court therefore reviewed the dividends claim findings solely in terms of the two definitions of shareholder oppression,[1024] and without regard to the corporation's fiduciary duties or the *Patton* and *Morrison* decisions.[1025] In light of Supreme Court's opinion in *Ritchie v. Rupe*, the *ARGO* court got that point exactly backwards. It is the shareholder oppression claim that does not exist, while the claim recognized in *Patton* remains the law.

The jury found that Martin engaged in a plan "to retain ARGO's earnings to buy out Shagrithaya's interest in ARGO without disclosing this plan to Shagrithaya," and that Martin caused ARGO to "retain earnings rather than paying a greater amount of dividends to its shareholders than it actually paid." [1026] The court of appeals held that there was sufficient evidence to support these findings and that the evidence and jury findings were consistent with the plaintiff's theory that "beginning at latest in 2003 and possibly as early as 2001, Martin began retaining ARGO's earnings for the purpose of buying out Shagrithaya's shares without telling him."[1027] The jury also found that Martin

> dominat[ed] and controll[ed] the Board of Directors of ARGO with the actual result of suppressing the issuance of dividends to Shagrithaya . . . for the purpose of preventing Shagrithaya from sharing in the profits to be derived from the operation of ARGO . . . [and] depreciating the value of the shares of stock in ARGO owned by

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[1020] *Id*. at 263.

[1021] *Id*.

[1022] *Id*. at 264.

[1023] *Id*. at 276.

[1024] *Id*. at 268 ("We first note that, although Shagrithaya asserted 'malicious suppression of dividends' as a separate cause of action, this claim is merely a form of minority shareholder oppression and must be analyzed as such.").

[1025] The court of appeals did acknowledge the plaintiff's reliance on *Patton v. Nicholas*, but held that the legal basis for that decision had been altered by the passage of the oppression provisions of the receivership statute and that cases like *Davis v Sheerin* subsequently made clear that the statutory shareholder oppression claim had subsumed the common-law malicious suppression of dividends claim. *See id*. at 268 n.5.

[1026] *Id*. at 268.

[1027] *Id*. at 269.

Shagrithaya to a lower value than his shares of stock would otherwise have.[1028]

The court of appeals rejected those findings.

The court of appeals' reasoning was based on three propositions, none of which had anything to do with the adequacy of the evidence, and each of which was inconsistent with the Supreme Court's reasoning in *Ritchie*: First, the court of appeals stated that, "to the extent dividends were 'suppressed' from being paid to Shagrithaya, they were also suppressed from being paid to Martin."[1029] This is a true, but utterly immaterial observation. In *Patton v. Nicholas*, exactly the same factual situation existed and yet the Supreme Court held that the plaintiffs were entitled to relief, and the Supreme Court in *Ritchie* reaffirmed as correct the holding in *Patton*. The implied conclusion of the court of appeals is that, so long as the money is still in the company, the minority shareholder has not been harmed, or at least the majority and minority share the same proportional benefits and disadvantages of that situation. That conclusion defies common sense. When the money is left in the company, both the minority and majority may retain their proportional equitable interests in the money in an abstract sense, but the majority shareholder has control and the ability to access the funds whenever he wants. The minority shareholder does not. The suppression of Shagrithaya's dividends was involuntary; the suppression of Martin's dividends was completely voluntary, subject to his control, and within his ability to manipulate for his own benefit. The court of appeals' reasoning would hold that there is no difference in value of $1 million in a trust fund that could not be accessed for 25 years and $1 million in a checking account. The difference to the trust beneficiary vs. the checking account holder is immense. That difference is exacerbated when the minority shareholder has an immediate need for the funds and the majority shareholder does not, or when the minority shareholder is not deriving other economic benefits from the company that the majority shareholder enjoys, such less than one-third the salary (*ARGO*) or no salary at all (*Patton*).

Second, the court of appeals stated that "Shagrithaya was not entirely prevented from 'sharing in the profits' of ARGO, because he had proportionally participated in three dividend payments over a four-year period totaling $25 million.[1030] Again, so what? The jury found that $65 million in dividends had been wrongfully withheld. The fact that $25 million had not been wrongfully withheld is immaterial. Moreover, a shareholder's right is to a "proportionate share in profits." The observation that the plaintiff was not "*entirely*" prevented from sharing in profits is irrelevant. Finally, the court of appeals stated: "Even assuming that the evidence supported the finding as to Martin's motivation [to depreciate the value of Shagrithaya's stock], there is no evidence to support a finding that Martin's actions resulted in lowering the value of Shagrithaya's stock."[1031] Exactly the same thing was true in *Patton*. In both *Patton* and *ARGO*, the courts noted that, because the companies were making money and because those profits were kept in the company, the value of the stock necessarily increased, not decreased.[1032] The court of appeal's observation is wrong on its face, first because it ignores

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[1028] *Id*.

[1029] *Id*.

[1030] *Id*.

[1031] *Id*.

[1032] *Id*. ("The evidence shows that the value of the company and Shagrithaya's shares continued to grow throughout the time period that Shagrithaya claims Martin was suppressing dividends. Shagrithaya directs us to no

the fact that the value of the stock *to Shagrithaya* may be diminished even though the value of the company as a whole is not. If the minority shareholder gets no economic benefit from stock ownership because no dividends are paid, particularly if the company is a subchapter S corporation so that the profits create tax liability to the minority owner or if the minority owner needs the money, then the value to that minority owner of his stock is vastly diminished by the intentional withholding of dividends. Every shareholder oppression scenario involves an effort by the majority to diminish the value of the stock to the minority by eliminating or impairing the benefits of ownership. As *Patton* clearly recognized, that is possible even though the cash stays in the company and the majority does not receive any disproportionate benefits from that cash. More importantly, the holding in *Patton* was that the suppression of dividends was wrongful based on the malicious intent, not on the success of diminishing the value of the shares. As the *Ritchie* court stated,

> when a corporate director violates the duty to act solely for the benefit of the corporation and refuses to declare dividends for some other, improper purpose, the director breaches fiduciary duties to the corporation, and the minority shareholders are entitled to relief, either directly to the corporation or through a derivative action.[1033]

Therefore, it is Martin's improper purpose, found by the jury, not the actual effect of his conduct, that establishes a valid cause of action.

The *ARGO* court concluded "that the evidence supports the jury's findings that Martin caused ARGO to retain earnings rather than pay a greater amount of dividends" and that the "evidence also supports the jury's finding that Martin retained earnings for the purpose of buying out Shagrithaya's shares without making Shagrithaya aware of this purpose," but that the evidence was legally insufficient to support a "finding that Shagrithaya was individually targeted for the purpose of preventing him from sharing in the profits of the company or that the value of his shares was depreciated by Martin's actions."[1034] Again, the court's reasoning is non-sense on its face. Obviously, the evidence supported a finding that Martin's actions were "individually targeted" against Shagrithaya—the evidence was that Martin was stockpiling cash to buy Shagrithaya's stock, not anybody else's stock. As noted above, there was ample evidence to support the jury findings regarding Martin's purpose; the court of appeals' basis for rejecting the findings was only that Martin was not entirely successful.

The *ARGO* court then analyzed the dividends findings in terms of the former shareholder oppression doctrine's two tests of defeating reasonable expectations and burdensome, harsh, or wrongful conduct. Within the confines of the pre-*Ritchie* law, its conclusions were perhaps not unreasonable. First, the court concluded that "Shagrithaya joined ARGO with no expectations of receiving dividends and Martin's conduct did not defeat Shagrithaya's specific

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evidence that the value of his shares was affected by Martin's actions."). Probably, the only factual situation in which a shareholder could ever prove damage to the value of his shares from stockpiling cash would be if there were an actual attempt to sell a third party, and the evidence proved that the price was diminished by the absence of dividends and would have been greater if dividends had not been suppressed.

[1033] Ritchie v. Rupe, 443 S.W.3d 856, 884 (Tex. 2014).

[1034] *ARGO*, 380 S.W.3d at 269–70.

expectations."[1035] That conclusion stretches the evidence slightly. The court's statement of the evidence was that Shagrithaya's expectation was that dividends would not be paid during the time that the parties were building the company. By implication, there would have been some expectation that profits would be distributed after that was done, but the court of appeals must have concluded that Shagrithaya never testified that this eventual payment of dividends was "central to his decision to join the venture." Next, the court held that "a shareholder may generally expect to share proportionately in the company's earnings, but a shareholder has no general expectation of receiving a dividend."[1036] Therefore, the only general expectation that Shagrithaya could have would be "in receiving a proportional share of any dividend the board of directors may choose to issue."[1037] That statement is somewhat problematic. The court accepts that all shareholders have a right to share proportionately in the company's earnings; however, there are only two ways that the earnings can be shared with the shareholders: salaries, bonuses, and other employment-related compensation, or dividends. However, if shareholders have no reasonable expectation in their continued employment, no reasonable expectation in their level of compensation, and no reasonable expectation in their receipt of dividends, then the reasonable expectation in a proportionate share of earnings is illusory because there is no reasonable expectation in any means of receiving those payments.

Finally, the court determines whether the facts found by the jury "constitute burdensome, harsh, or wrongful conduct."[1038] The court concludes in the negative: "Because Martin's 'suppression of dividends' did not substantially defeat Shagrithaya's expectations or prejudice his rights as a shareholder, we conclude this conduct did not amount to minority shareholder oppression."[1039] This conclusion is based on the court's argument that

> [b]uying out a minority shareholder's interest is not an improper purpose for retaining a company's earnings. Such a purpose becomes improper only if it negatively impacts the minority shareholder's rights. As Shagrithaya notes in his brief, the two ways a minority shareholder's rights may be impacted are if he is prevented from sharing in the profits of the company or the sale value of his shares in the marketplace is depreciated. But, as shown above, neither of these things occurred.[1040]

Under *Ritchie*, none of the *ARGO* court's reasoning would have been relevant. The derivative claim recognized in *Ritchie*, based on its construction of *Patton*, did not inquire into the reasonable expectations of the shareholder or even the nature of the conduct. The sole issue is the purpose of the action, whether the director "violates the duty to act solely for the benefit of the corporation and refuses to declare dividends for some other, improper purpose."[1041] The only statement in *ARGO* that addresses this issue is the court's bare assertion, without any citation of authority, that "[b]uying out a minority shareholder's interest is not an improper

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[1035] *Id*. at 270.
[1036] *Id*.
[1037] *Id*.
[1038] *Id*. at 271.
[1039] *Id*.
[1040] *Id*. at 270–71.
[1041] 443 S.W.3d 856, 884 (Tex. 2014).

purpose for retaining a company's earnings."[1042] That statement is completely contrary to settled law. The buy-out of a minority shareholder does not benefit the corporation in any way. It only benefits the majority shareholder who acquires a greater percentage of the benefits of ownership, and, depending on the fairness of the price, the minority shareholder. Quite simply, a corporation's use of its retained earnings to purchase the interests of any particular shareholder[1043] is not a corporate purpose at all.[1044] The jury's finding that Martin's purpose was (1) to prevent Shagrithaya from sharing in the company's profits, (2) to reduce the value of Shagrithaya's shares to Shagrithaya, and (3) ultimately to use Shagrithaya's own money that has been retained in the company for the purpose of buying out his interests and enlarging Martin's interests is quite clearly a purpose that was not "solely for the benefit of the corporation." Martin clearly violated his fiduciary duties to ARGO, as defined by *Ritchie*, and would have been entitled to the equitable relief awarded in *Patton*, based on the jury's findings.

### *2. Challenging "No Dividend" Policy*

A related concern is where a corporation, with the consent of all shareholders, follows a policy of distributing profits by means other than dividends, typically salary and bonuses, and a change of circumstances occurs whereby some shareholders no longer benefit proportionately. In the oppression context, this often occurs as a result of the majority terminating the employment of the minority, but it can happen in many other ways: voluntary resignation, retirement, inability to work due to disability, or death of the employee resulting in the stock passing to heirs not involved in the business. In each of these situations, what was once a fair financial structure for the shareholders becomes an unfair one. The *Ritchie* Court specifically noted that when dividends are not paid, "a minority shareholder who is discharged from employment and removed from the board of directors is effectively denied any return on his or her investment."[1045] Often, the shareholders still employed or the directors will argue that the long-standing policy against payment of dividends, to which the plaintiff had previously agreed, is binding and cannot be changed. This argument is wrong unless the specific restrictions on the ability to declare dividends are written into the certificate of formation.[1046] Nevertheless, directors may use their discretion to continue to abide by an

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[1042] *ARGO*, 380 S.W.3d at 270.

[1043] A distinction is made between the repurchase of shares of a particular minority shareholder in a closely-held corporation resulting from an agreement between the minority shareholder and the majority shareholder and a corporate redemption in a public corporation that is tendered to all shareholders. The latter situation is similar to a dividend in that it benefits all shareholders.

[1044] "[O]rdinarily, a corporation has no special interest in the opportunity to purchase its own shares False" Alexander v. Sturke, 909 S.W.2d 166, 170 (Tex. App.—Houston [14th Dist.] 1995, writ denied). *See also* Equity Corp. v. Milton, 213 A.2d 439, 443 (Del. Ch. 1965) ("[T]he acquisition of its own capital stock is not ordinarily an essential corporate function"), *aff'd*, 221 A.2d 494 (Del. 1966); Brophy v. Cities Serv. Co., 70 A.2d 5, 8 (Del. Ch. 1949) ("The acquisition of its own capital stock is not ordinarily an essential corporate function"); Katz Corp. v. T.H. Canty & Co., Inc., 362 A.2d 975, 980 (Conn. 1975) ("Ordinarily, a corporation has no interest in its outstanding stock . . . ."); PJ Acquisition Corp. v. Skoglund, 453 N.W.2d 1, 10 (Minn. 1990) ("Ordinarily, a corporation has no interest in its outstanding stock . . . .").

[1045] 443 S.W.3d at 879 n.39 (citing Douglas K. Moll, *Reasonable Expectations v. Implied-in-Fact Contracts: Is the Shareholder Oppression Doctrine Needed?*, 42 B.C. L. REV. 989, 1067 (2001)).

[1046] *See* TEX. BUS. ORGS. CODE ANN. § 21.310 (West 2006). Also a restriction on the power of directors to make distributions must be stated in the certificate of formation. *See id.* § 21.303(a). A "distribution" includes

unwritten, informal policy, even though that policy is not binding and now works an injustice.

In these situations, the directors are causing the corporation to violate its fiduciary duties to treat all shareholders impartially and not to impair the rights as shareholders, which include a proportional share in profits. Either by a claim for breach of trust or a derivative claim for suppression of dividends, courts should be able to grant equitable relief to the disadvantaged shareholders. One Delaware case involved doctors in a professional corporation MRI clinic that had distributed profits through payment of above-market fees for reading MRIs to the shareholder doctors. That practice worked well to distribute corporate profits on a pro rata basis until some of the doctors withdrew from the arrangement. The Delaware Chancery Court stated that the board has a fiduciary duty to reassess the unfair situation.[1047] In *Gimpel v. Bolstein*, the plaintiff was fired for good cause, which the New York court held could not constitute shareholder oppression.[1048] However, the resulting unfairness of the corporation's firmly established policy of not paying dividends prompted the court to "fashion a remedy" and order the majority to "make an election: they must either alter the corporate financial structure so as to commence payment of dividends, or else make a reasonable offer to buy out [the plaintiff's] interest."[1049]

Similarly, in *Braswell v. Braswell*, the wife of the majority shareholder in a closely held corporation was awarded shares in the company as a result of a divorce.[1050] The wife argued that the division of the stock was not equitable because she was now a shareholder in a corporation that was subject to the control of her ex-husband. The Waco Court of Appeals noted that the corporation had never before paid dividends, but reasoned that both husband and wife had lived on the husband's salary taken out of the corporation and that it would have been costly in taxes and unwise for the corporation to pay dividends prior to the divorce. "We do not believe these facts raise a presumption that the corporation acting through its dominant officer and stockholders will not now regularly declare and pay reasonable dividends. If they should improperly refuse to do so, then any minority stockholder has his or her legal remedy"[1051]—specifically citing *Patton* and *Morrison v. St. Anthony Hotel*.

### *3. Defacto Dividends*

Allegations that directors or controlling shareholders are manipulating dividends to "oppress" minority shareholders typically arise when the majority shareholders not only withhold dividends but also use some alternative method to distribute the corporation's profits exclusively to themselves—frequently, by inflating their own salaries.[1052] The "[r]efusal to pay

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dividends, share repurchases or redemptions, and liquidation payments. *Id.* § 21.002(6)(A).

[1047] *See* Del. Open MRI Radiology Ass'n v. Kessler, 898 A.2d 290, 321 (Del. Ch. 2006).

[1048] 477 N.Y.S.2d 1014, 1020–21 (N.Y. Sup. Ct. 1984).

[1049] *Id.*

[1050] 476 S.W.2d 444, 447 (Tex. Civ. App.—Waco 1972, writ dism'd).

[1051] *Id.* (citing Patton v. Nicholas, 279 S.W.2d 848, 853 (Tex. 1955), and Morrison v. St. Anthony Hotel, 295 S.W.2d 246, 250 (Tex. Civ. App.—San Antonio 1956, writ ref'd n.r.e.)).

[1052] Ritchie v. Rupe, 443 S.W.3d 856, 885 (Tex. 2014) (citing Boehringer v. Konkel, 404 S.W.3d 18, 31–32 (Tex. App.—Houston [1st Dist.] 2013) (addressing failure to pay dividends couples with increase in controlling shareholders-director's salary)).

dividends [and] paying majority shareholders outside the dividend process,"[1053] the *Ritchie* Court argued, "may be redressed through a derivative action, or through a direct action brought by the corporation, for breach of fiduciary duty."[1054] While that may be true in most instances, the same conduct also constitutes a corporate breach of trust in failing to deal with shareholders impartially and appropriating the minority's proportionate share of the profits through what are actually de facto dividends being paid the majority. The differences between addressing this oppressive conduct derivatively as withholding dividends plus excessive compensation versus directly as a breach of trust in the disproportionate payment of defacto dividends are real and significant.

"A distribution by a corporation to its shareholders may constitute a dividend in law even though not formally designated as a dividend by the board of directors."[1055] In *Moroney v. Moroney*,[1056] a guardian controlled a corporation with 500 shares, one he owned personally, and the other 499 he held in trust for the wards of the estate. The guardian caused the corporation to pay himself a large sum of money, and the wards of the estate later sued him for their 499/500 share. The defense was that the money was not a distribution but a misappropriation, and only the corporation could bring the suit. The Texas Commission of Appeals held:

> Now, it is not essential to the right to receive a dividend that there should have been a formal declaration of a dividend, but where the corporation sets apart a fund for distribution to its stockholders to such extent as to become segregated from the property of the corporation, such property henceforth becomes, equitably, the stockholders' property. There has been in legal effect a declaration of a dividend, and of course if such fund is actually delivered to the stockholders, there has been a payment, and the fund is legally that of the stockholder. In other words, where there has been such a segregation of the corporate funds, and such a dedication to the stockholders, the assets thus segregated cease to belong to the corporation, but do belong to the stockholders individually.[1057]

The court held that the payments were "in effect" dividends even though "there was never at any time a formal declaration of dividends"—it being "presumed that [the corporation] intended to do a lawful thing, and that the sums paid represented a legal liability of the corporation."[1058] "The evidence indicates the corporation was a prosperous concern, and by common consent it pursued this method of distributing its proceeds to the rightful owners of such profits. The transaction evidences an intention to distribute the proceeds of the business to

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[1053] *Id.* at 885 n.53 (Tex. 2014).

[1054] *Id*. at 887.

[1055] Legrand-Brock v. Brock, 246 S.W.3d 318, 322 (Tex. App.—Beaumont 2008, pet. denied). S*ee also* Ramo, Inc. v. English, 500 S.W.2d 461, 465 (Tex. 1973) ("We are unwilling to permit the dividend limitation to be circumvented by so transparent a device as entering the withdrawals on the books as 'accounts receivable' and calling them loans.").

[1056] Moroney v. Moroney, 286 S.W. 167 (Tex. Comm'n App. 1926, judgm't affirmed).

[1057] *Id.* at 169–70.

[1058] *Id.* at 170.

the rightful owners."[1059] Furthermore, it made "no difference whether the corporation, Moroney Hardware Company, does or does not have a cause of action against [the guardian]. The estate recovers in this case upon the merits of its own claim."[1060] As the Texas Supreme Court has held: "[W]hether or not a corporate distribution is a dividend or something else, such as a loan, gift, compensation for services, repayment of a loan, interest on a loan, or payment for property purchased, presents a question of fact to be determined in each case."[1061]

Assume that a corporation is paying no dividends, that the 40% minority shareholder draws no salary, and that all corporate profits are consumed in payment of a large salary to the 60% majority shareholder—so that, in reality, part of the payment to the majority is compensation for services and part is a distribution of profits, a de facto dividend. Under the approach described in *Ritchie*, the plaintiff is required to address two very different questions. First, was the majority shareholder excessively compensated? This requires an inquiry into whether there was wrongdoing by the directors in setting the majority shareholder's salary and will focus on whether the majority shareholder is being paid above-market.[1062] Because of the wide range of executive salaries, the plaintiff's burden is very difficult. Second, the plaintiff must prove that dividends should be declared. This requires proof that the decision not to pay dividends was based on a purpose other than benefiting the corporation; however, this is a difficult thing to prove in the face of a director's claim of plausible corporate purposes and a judicial policy of extreme deference on dividend decisions. If the plaintiff is successful on both questions, the de facto dividend is cancelled and reissued properly—the defendant puts the money back into the corporation, and the plaintiff receives his portion of the de facto dividend.[1063] If the amount of the de facto dividend was $120,000, then the plaintiff would recover his 40%, or $48,000.

If the plaintiff were to approach the problem not as a breach of fiduciary duties to the corporation, but as a breach by the corporation as a trustee, the analysis is very different. "When dividends are declared, the corporation becomes indebted to [each] stockholder[] for the amounts of [his] respective shares."[1064] Dividends cannot be rescinded.[1065] The factual question would not involve an issue of wrongdoing or of business judgment but merely one of value. Recognizing that it is perfectly appropriate to distribute profits in a closely-held corporation by means of salary and bonuses,[1066] the jury would only need to determine how much of the payment to the majority shareholder was for services and how much was

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[1059] *Id.*

[1060] *Id.*

[1061] *Ramo, Inc*., 500 S.W.2d at 467.

[1062] Gibney v. Culver, No. 13-06-112-CV, 2008 WL 1822767, at *15 (Tex. App.—Corpus Christi Apr. 24, 2008, pet. denied) (mem. op.).

[1063] As a practical matter in this particular hypothetical, dealing with the second question would probably not be necessary because the court would treat the derivative action as a direct action for purposes of the remedy, and the plaintiff could receive his share of the overpayment directly as damages. TEX. BUS. ORGS. CODE ANN. § 21.563 (West 2007). However, in any situation involving prospective relief, both questions would need to be addressed.

[1064] Keller v. Keller, 141 S.W.2d 308, 311 (Tex. 1940).

[1065] *See id.* (dividends, once declared, "are not subject to change merely at the choice of a stockholder."); C.I.R. v. Cohen, 121 F.2d 348, 349 (5th Cir. 1941) ("Under the law of Texas, a declaration of dividends creates a debt owed by the corporation in favor of each stockholder which cannot be rescinded.").

[1066] *See* Moll, *Shareholder Oppression in Texas*, *supra* note 25, at 37.35.

distribution of profit? Because the "directors must make compensation decisions in compliance with the formal fiduciary duties that they, as officers or directors, owe to the corporation, and thus to the shareholders collectively,"[1067] and because "equity regarding as done that which ought to be done,"[1068] the jury would have to assume that the compensation for services would be valued at the lowest amount that comparable services could be procured on the market, and the rest is profit distribution. If the amount of the de facto dividend actually paid to the majority shareholder was $120,000, then the corporation would have a fiduciary duty to pay the minority shareholder $80,000, because the total dividend constructively declared would have been $200,000—60% to the majority ($120,000) and 40% to the minority ($80,000). This would clearly represent an instance where the legal remedy ($40,000) is not adequate when compared with the equitable remedy ($80,000).

Texas courts have frequently been willing and able to find a variety of financial benefits that majority shareholders confer on themselves to be de facto dividends. In *Ramo, Inc. v. English*,[1069] the corporation distributed substantial sums of money to the controlling shareholder, which were recorded on the books as advances. Only the first advance was documented with a board resolution; none of the advances were evidenced by a promissory note; and apparently, the advances were without interest. The jury found that the controlling shareholder had no intention to repay the money.[1070] A lender contended that these distributions were not loans,[1071] but were actually dividends in violation of a covenant in the security agreement. The Texas Supreme Court held that whether the distributions were loans or dividends was a question for the jury, but that the evidence would have supported a finding that the distributions were really dividends if a jury question had been submitted.[1072]

In *Rivas v. Cantu*,[1073] the plaintiff sued the controlling shareholder for breach of contract and fraud for having failed to transfer 50% of the shares in a corporation as promised prior to incorporation. The plaintiff claimed as special damages 50% of the amount of "constructive dividends" that the controlling shareholder had received. The court of appeals approved this

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[1067] Ritchie v. Rupe, 443 S.W.3d 856, 883 (Tex. 2014).

[1068] Sanderson v. Sanderson, 109 S.W.2d 744, 748 (Tex. 1937); First Heights Bank, FSB v. Gutierrez, 852 S.W.2d 596, 605 (Tex. App.—Corpus Christi 1993, writ denied); Dixon v. Huggins, 495 S.W.2d 621, 625 (Tex. Civ. App.—Waco 1973, writ dism'd); King Land & Cattle Corp. v. Fikes, 414 S.W.2d 521, 524 (Tex. Civ. App.—Fort Worth 1967, writ ref'd n.r.e.). *See also* White v. Hancock, 238 S.W.2d 801, 803 (Tex. Civ. App.—Fort Worth 1951, no writ) ("Equity regards and treats as done that which in fairness and good conscience ought to be done.").

[1069] Ramo, Inc. v. English, 500 S.W.2d 461 (Tex. 1973).

[1070] *Id.* at 464.

[1071] The court noted:

> A loan is an advance of money on an agreement, express or implied, to repay at some time in the future, while the term 'dividend' as ordinarily used means a corporate distribution that the shareholder is entitled to receive and retain without any obligation of repayment. A basic and essential difference between a loan and a dividend then is the presence or absence of a legal obligation to repay.

*Id.* at 465.

[1072] *Id.* at 467 ("To weigh the evidence, draw inferences from the facts, and choose between conflicting inferences is, of course, the function of the trier of fact. The evidence in the present case would support a finding that the advances were dividends, but it is not conclusive. The question is an issue of fact, but no issue fairly presenting that question was submitted or requested.").

[1073] 37 S.W.3d 101 (Tex. App.—Corpus Christi 2000, pet. denied).

measure of damages.[1074] The court noted that "a constructive dividend occurs when an expenditure is made by a corporation for the personal benefit of a stockholder, or corporate-owned facilities are used by a stockholder for his personal benefit" and that "the crucial concept is that the corporation conferred an economic benefit on the stockholder without expectation of repayment."[1075] The court held that constructive dividends could be established by evidence of excessive compensation paid by the corporation to family members of the controlling stockholders; however, a "constructive dividend does not occur automatically when a stockholder's family member works for the corporation, but only when that relative is overcompensated."[1076] There must be evidence that compensation was paid for work that was not done, or work that was not needed by the corporation, or that the compensation for the services performed was unreasonably high.[1077]

In *Davis v. Sheerin*, the jury found that "appellants received informal dividends by making profit sharing contributions for their benefit and to the exclusion of appellee."[1078] The trial court awarded $20,893 to the plaintiff individually on a de facto dividends claim, separate and apart from his shareholder oppression and derivative claims.[1079] In *Redmon v. Griffith*, the plaintiff's pleading that defendants made improper loans to themselves, paid personal expenses from corporate funds, and paid excessive dividends to themselves was held to properly state a pattern of oppressive conduct.[1080] In *Boehringer v. Konkel*, the majority shareholder withheld dividends for two years, claiming that the corporation did not have the funds to pay dividends in those years.[1081] However, the defendant also increased his salary to $20,000 per month during this time. The court concluded that the defendant "withheld [payment] of a dividend and used his two-fold pay increase as a means of denying [the minority shareholder] his proportionate participation in the company's earnings . . . ."[1082] The court stated that the sizeable salary increase for the majority shareholder resulted in a "de facto dividend" to the exclusion of the minority shareholder.[1083] In *In re White*, the court held payments of bonuses to the majority shareholders that tracked the profits of the company constituted "$4,900,000 in disguised dividends."[1084]

The equitable remedy for de facto dividends described here may result in de facto dividend declarations that subject the majority shareholder to additional liability to the corporation. The premise of the plaintiff's claim is that funds taken from the company by the majority shareholder were constructive dividends—meaning that a court of equity would presume that was "done that which ought to be done,"[1085] and the corporation had declared a

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[1074] *Id.* at 118.

[1075] *Id.* (citing Hillsboro Nat'l Bank v. Comm'r, 460 U.S. 370, 392, (1983). *See* Ireland v. United States, 621 F.2d 731, 735 (5th Cir.1980)).

[1076] *Rivas*, 37 S.W.3d at 119.

[1077] *Id.*

[1078] 754 S.W.2d 375, 382 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

[1079] *Id*. at 378.

[1080] Redmon v. Griffith, 202 S.W.3d 225, 235 (Tex. App.—Tyler 2006, pet. denied).

[1081] Boehringer v. Konkel, 404 S.W.3d 18, 28 (Tex. App.—Houston [1st Dist.] 2013, no pet.).

[1082] *Id.* at 31.

[1083] *Id.*

[1084] *In re White*, 429 B.R. 201, 214 (Bankr. S.D. Tex. 2010).

[1085] Sanderson v. Sanderson, 109 S.W.2d 744, 748 (Tex. 1937); First Heights Bank, FSB v. Gutierrez, 852

dividend in the amount reflected by what was paid to the majority. If the majority owns 60% of the stock and takes $600,000 in defacto dividends, then the actual amount of the constructive dividend declaration would be $1 million, and the corporation would owe the minority shareholder his 40% or $400,000 of the constructive dividend. What if the corporation doesn't have $400,000? Directors are prohibited by statute from declaring dividends that would render the corporation insolvent or exceeds the distribution limit.[1086] The distribution limit for dividends is the amount of the surplus of the corporation,[1087] meaning the amount by which the net assets of the company exceed the stated capital of the company.[1088] If the majority shareholder has been doing a thorough job of cleaning out the excess profits of a corporation through de facto distributions to himself, then the amount of the grossed-up total constructive dividend declaration would frequently exceed the corporation's surplus, in which case directors who vote for or assent to such a de facto dividend will be jointly and severally liable to the corporation for the amount by which the distribution exceeds the limit.[1089] The practical result is that the majority shareholder would be personally responsible for funding the plaintiff's dividend if the corporation were unable to do so. However, the liability for an illegal dividend is solely to the corporation,[1090] therefore, this claim would be required to be asserted by the minority shareholder as a derivative claim.

### *4. Statute of Limitations on Dividend Claims*

Specifically, with respect to dividend and de facto dividend claims, a unique tolling doctrine developed. First, each dividend is a separate transaction, and each refusal to pay is also a separate cause of action.[1091] Second, the corporation is deemed to hold all unpaid dividends in trust for the benefit of the shareholder and such dividends are payable upon demand.[1092] The shareholder

> is under no obligation to draw or demand his dividends within any prescribed period. He may leave them with the corporation, if he chooses, and be under no default. The debt which a declared dividend creates on the part of the corporation to the stockholder is one payable only on demand, as is the obligation of a bank to its depositors. It is not subject to limitation until there has been a demand upon the corporation and a refusal to pay.[1093]

However, the court held:

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S.W.2d 596, 605 (Tex. App.—Corpus Christi 1993, writ denied); Dixon v. Huggins, 495 S.W.2d 621, 625 (Tex. Civ. App.—Waco 1973, writ dism'd); King Land & Cattle Corp. v. Fikes, 414 S.W.2d 521, 524 (Tex. Civ. App.—Fort Worth 1967, writ ref'd n.r.e.). *See also* White v. Hancock, 238 S.W.2d 801, 803 (Tex. Civ. App.—Fort Worth 1951, no writ) ("Equity regards and treats as done that which in fairness and good conscience ought to be done.").

[1086] TEX. BUS. ORGS. CODE ANN. § 21.303(b) (West 2015).

[1087] *Id.* § 21.301(1)(B).

[1088] *Id.* at (12). The "stated capital" is sum of the par value of the stock, plus the consideration received for non-par-value stock, plus any stated capital allocated in a stock dividend or by resolution of the board. *Id*. at (11).

[1089] *See id.* § 21.316(a).

[1090] *See* Smith v. Chapman, 897 S.W.2d 399, 401 (Tex. App.—Eastland 1995, no writ).

[1091] Cavitt v. Amsler, 242 S.W. 246, 247 (Tex. Civ. App.—Austin 1922, writ dism'd w.o.j.).

[1092] *Id.* at 248.

[1093] Yeaman v. Galveston City Co., 167 S.W. 710, 724. (Tex. 1914). *See also Cavitt*, 242 S.W. at 248 ("[U]ntil a stockholder makes a demand for the payment of his dividends and the same is refused, the statute of limitation will not begin to run.").

> it is not necessary that a specific demand for dividends should be made, and the same should be refused, in order to put the statute of limitation in motion. If the acts or words or both, of the corporation, clearly and unequivocally indicate to a stockholder that the corporation will not pay a dividend to him, this would be equivalent to a demand and refusal for the payment of such dividend.[1094]

The shareholder must have clear notice of the refusal to pay,[1095] and because of the fiduciary relationship, the diligence required of the shareholder is not "as prompt and as searching an inquiry into the conduct of the other party as where the parties were strangers or were dealing with strangers."[1096] The mere opportunity or power to investigate is not sufficient to start the running of the statute of limitations; actual notice, not constructive notice, is required.[1097]

## IX. CONCLUSION

Courts may be "powerless to redress many forms of oppression practiced upon the minority under the guise of legal sanction,"[1098] but not all. A court may grant relief for "oppression on the part of the company or its controlling agency clearly subversive of the rights of the minority, or of a shareholder."[1099] Such cases of extreme oppressive conduct constitute a "breach of trust, for which the courts will afford a remedy."[1100] In fashioning such a remedy, "[w]isdom would seem to counsel tailoring the remedy to fit the particular case,"[1101] taking due regard of "the malicious character of the misconduct heretofore involved and the consequent possibility of its repetition."[1102] In an appropriate case, under the existing common law, "Texas courts, under their general equity power, may decree a 'buy-out' . . .[] where less harsh remedies are inadequate to protect the rights of the parties."[1103]

The purpose of this article has been to identify with a degree of specificity the "gaps" that the *Ritchie* Court acknowledged now exist in Texas law after the demise of the shareholder oppression doctrine. We have attempted to identify legal rights and remedies that "already exist"[1104] and to some extent fill in the gaps left by the *Ritchie* decision. We have gone back to the pre-shareholder oppression case law, including the cases relied on by the Court in *Ritchie*

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1094 *Cavitt*, 242 S.W. at 248.

1095 *Yeaman*, 167 S.W. at 724 ("And when a corporate act is invoked as a repudiation of a shareholder's stock or a conversion of its profits, before affecting his rights with limitation, it is only just to require that he or those standing in his stead have notice of it."). *See also id.* ("Though considered a debt, as a shareholder's dividends are payable by the corporation only on demand, its holding of them until the demand is in the nature of a trustee relation; and in our opinion the same rule which requires notice to a cestui que trust of the trustee's repudiation of the trust, to set limitation in motion against him, should govern in the case of a conversion by a corporation of dividends belonging to one of its stockholders.").

1096 Bush v. Stone, 500 S.W.2d 885, 890 (Tex. Civ. App.—Corpus Christi 1973, writ ref'd n.r.e.).

1097 *Id.* (finding that "actual notice of the fraud before the limitations statute is set into motion").

1098 Tipton v. Ry. Postal Clerks' Inv. Ass'n, 173 S.W. 562, 567 (Tex. Civ. App.—Fort Worth 1914, no writ).

1099 Cates v. Sparkman, 11 S.W. 846, 849 (Tex. 1889).

1100 Patton v. Nicholas, 279 S.W.2d 848, 854 (Tex. 1955).

1101 *Id.* at 857.

1102 *Id.* at 858.

1103 Davis v. Sheerin, 754 S.W.2d 375, 380 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

1104 Ritchie v. Rupe, 443 S.W.3d 856, 879 (Tex. 2014).

and *Sneed*, and other cases decided in the same time period, and have identified well-established shareholder rights and interests and duties owed by the corporation to individual shareholders. Finally, we have attempted to define the elements and remedies of the common-law cause of action for breach of trust as it currently exists in Texas common law and as it might logically be applied in factual situations previously remedied under the shareholder oppression doctrine. While we have brought together some concepts in new ways and have drawn some inferences from existing case law, nothing that is proposed in this article is new. Nothing is suggested that would require "directors to act in the best interest of individual shareholders at the expense of the corporation"[1105]—rather, the concepts discussed here are based on protected rights of shareholder and duties of the corporation. Discretion to determine what is in the best interest of either the corporation or the shareholder is beside the point. Finally, the common-law cause of action described here is certainly "far more concrete than" the term "oppressive"[1106] as previously developed in the former shareholder oppression doctrine.

Although the Texas Supreme Court did not hesitate to overturn three decades of common law developed by the courts of appeals as "new"—a body of law that an entire generation of business attorneys and business persons accepted and utilized to guide and govern their actions—the Supreme Court took utmost care to remain consistent with even nineteenth century Texas Supreme Court opinions and lower court opinions that have stood the test of time. The majority opinion in *Ritchie* quoted Justice Hecht's eloquent statement that the Texas Supreme Court

> as steward of the common law, possesses the power to recognize new causes of action, but the mere existence of that power cannot justify its exercise. There must be well-considered, even compelling grounds for changing the law so significantly. Where, as here, no such grounds are given, the decision is more an exercise of will than of reason.[1107]

The rights, interests, causes of action, and remedies outlined in this article do not involve a change in the law, but are based on well-established law and are available to address oppressive conduct. As the "steward of the common law," the Texas Supreme Court should find that the legal concepts described in this article are consistent with the precepts of the *Ritchie* opinion and serve in large measure to fill in the gaps acknowledged by the Court in the legal protection of minority shareholder interests.

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[1105] *Id*. at 888.

[1106] *Cf*. *id*. at 890.

[1107] Twyman v. Twyman, 855 S.W.2d 619, 630 (Tex. 1993) (Hecht, J., joined by Enoch, J., concurring in part and dissenting in part), quoted by *Ritchie*, 443 S.W.3d at 891.