# SHAREHOLDER OPPRESSION ACTIONS

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# SHAREHOLDER OPPRESSION ACTIONS

## I. INTRODUCTION

Under the traditional model of corporate governance the board of directors, rather than the shareholders, direct corporate affairs. *See* D. Moll and R. Ragazzo, The Law of Closely Held Corporations at p. 1-2. (Aspen Publishers 2011) [hereinafter "Moll"]. Other than voting for the directors, stockholders typically do not play an active role in management. *See id.* In addition, many shareholders in publicly traded companies will lack enough voting power to change the board of directors if they disagree with their decisions. The decision of who serves on the board typically rests in the hands of a few large investors. Further, except in self-dealing transactions, the board's management decisions are protected by the business judgment rule. *See generally id* at §6.02 [C], at pp. 6-30-60. Under this rule, courts are reluctant to second guess business decisions, even if they turn out to be ill-advised or even disastrous.

Consequently, a minority shareholder in a publicly-traded corporation has but one remedy if she disagrees with the company's management: she can sell her stock. The threat of enough shareholders selling their stock because they are dissatisfied with the company's management provides an incentive for management to make good decisions. But selling stock is not a realistic option for a minority shareholder in a privately-held company. There is often little to no market for such stock. *See id.* At p. 7-4. And any buyer would likely seek a substantial price discount due to the illiquidity of the stock and the lack of control. That is particularly true if the reason the minority shareholder is selling is dissatisfaction with and inability to change current management.

Moreover, shareholders in privately-held companies—especially closely-held companies—have expectations different than those of shareholders in publicly-traded companies. First, they may expect to have a job with the company. *See id.* at p. 7-3. Indeed, a salary may be the main if not only way that a shareholder can recoup her investment in a small company that retains its earnings to grow its business and does not pay dividends. *See id.* at p. 7-6. In addition, a shareholder in a small private company may reasonably expect to have a say in management and serve on the board of directors—something a shareholder in Exxon, for example, would not likely expect. *See id.* at p. 7-3.

The shareholder with a majority or controlling interest typically controls the board of a closely-held corporation. *See id.* at p. 7-4. That control gives that shareholder the ability to cause the corporation to do things that harm the minority shareholders. *See id.* at p. 7-4-5. When these acts prevent the minority shareholder's participation in the business, they are commonly referred to as a "freeze out" or a "squeeze out." *See id.* at p. 5. Other common acts of oppression include: firing a minority shareholder from a job with the company and/or from the board; denying the shareholder access to information; withholding dividends and diverting corporate funds or opportunities to the controlling shareholder. *See id.* at p. 7-5-6.

The shareholder oppression doctrine has arisen in Texas (and elsewhere) as a means of protecting a minority shareholder from abuses of power by a majority or controlling shareholder. Although it did not use the term "shareholder oppression," the Texas Supreme Court recognized this type of claim as early as 1955. And the concept is now codified in the Texas statutes authorizing appointment of receivers. In essence, the doctrine allows a minority shareholder to assert claims against the controlling shareholder for acts that: 1) violate the minority shareholder's reasonable expectations when entering the venture or 2) are burdensome, harsh and wrongful and violate the standard of fair dealing. A finding of oppression authorizes a court to fashion a variety of equitable remedies, including forced buyouts, injunctions requiring dividends, appointment of agents, financial advisors or receivers and other remedies. This article examines Texas case law on shareholder oppression.

## II. THE SHAREHOLDER OPPRESSION DOCTRINE IN GENERAL

Texas law has long recognized that a minority shareholder has a cause of action against a majority or controlling shareholder for oppressive conduct. *See Ritchie v. Rupe*, 339 S.W.3d. 275, 289-94 (Tex. App.—Dallas 2011, pet. denied) (discussing the shareholder oppression doctrine in general and key Texas cases applying it). In fact, as early as 1929 a Texas court recognized that shareholders can sue in equity "where the majority of shareholders themselves are oppressively and illegally pursuing a course in the name of the corporation, which is in violation of the rights of the other shareholders, and which can only be restrained by the aid of a court of equity…." *Gibbons Mfg. v. Milan*, 17 S.W.2d 844, 846-47 (Tex. Civ. App.−Texarkana 1929, no writ) (citing *Hawes v. City of Oakland*, 104 US 450 (1881)). A shareholder oppression claim is not limited to suits against a majority shareholder; rather, it may be brought against those who control the corporation even if no one person owns a majority of the stock. *See Ritchie*¸ 339 S.W.3d at 290.

The term "shareholder oppression" is "expansive and covers a multitude of situations dealing with improper conduct." *Id.* at 289. There is no set standard for determining whether shareholder oppression has occurred. *In re Mandel*, ____ Bankr. ____, 2011 WL 4599969, *23 (Bankr. E.D. Tex. Sept. 30, 2011) (citing *Davis v. Sheerin*, 754 S.W.2d 375 (Tex. Civ. App.—Houston [1st Dist.] 1988, writ denied)); *In re White*, 429 B.R. 201, 213 (S.D. Tex. 2010) (same). *But cf. Allen v. Devon Energy Holdings, LLC*, ____ S.W.3d ____, 2011 WL 3208234 *32 (Tex. App.−Houston [1st Dist.] July 28, 2011, no pet.) (suggesting that conduct has to have been previously recognized as oppressive before it will support an oppression claims).

"Texas Courts have generally recognized two non-exclusive definitions for 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."

*Ritchie*, 339 S.W.3d at 289 (citing *Willis v. Bydalek*, 997 S.W.2d 798, 801 (Tex. App.—Houston [1st Dist.] 1999, pet. denied) and *Redmon v. Griffith*, 202 S.W.2d 225 (Tex. App.—Tyler 2006, pet. denied)).

Oppressive conduct is more easily found in closely-held corporations. In fact, courts widely apply theories of liability and recovery for oppressive conduct in closely-held corporations where it is easier for the majority to oppress the minority. *Davis v. Sheerin*, 754 S.W.2d 375, 381 (Tex. App.—Houston [1st Dist.] 1988, writ denied). But shareholder oppression is not limited to close corporations. *Redmon v. Griffith*, 202 S.W.3d at 234.

Under the first definition, a minority shareholder's reasonable expectations that can form the basis for an oppression claim fall into two broad categories: specific reasonable expectations and general reasonable expectations. *See Ritchie*, 339 S.W.3d at 290-91 (citing D. Moll, <u>Shareholder Oppression & Reasonable Expectations: Of Change, Gifts, and Inheritances in Close Corporation Disputes</u>, 86 MINN. L. REV., 77, 765-77 (2002)). Specific reasonable expectations are those specifically agreed to or expected as part of the transaction forming the particular corporation or that may develop over time. *Id.* Examples are employment in a corporation or a say in management. *Id.* General reasonable expectations arise from the mere status of being a shareholder. *Id.* Some examples are the right to proportionate share of earnings, the right to any stock appreciation, the right (with a proper purpose) to inspect the corporate records and the right to vote if the stock has voting rights. *Id.* at 291-92. One of the general reasonable expectations of any property owner, including a stockholder, is the right of free alienation of that property. *Id.* at 292.

The second definition—burdensome, harsh or wrongful conduct; lack of probity and fair dealing in the company's affairs to the prejudice of some members; or visible departure from the standards of fair dealing in violation of fair play on which each shareholder is entitled to rely—is essentially one of fair dealing. *See id.* at 294. This definition focuses more on the conduct of those controlling the corporation than the minority shareholder's reasonable expectations. *Id.* The standards of fair dealing include requiring those in control to act fairly and reasonably in connection with a shareholder's efforts to sell stock to a third party and not adopt policies that unreasonably restrain or prohibit the sale of stock. *Id.* This second definition of oppression will often overlap with the reasonable expectations definition "because the standards of fair dealing on which all shareholders are entitled to rely will often be conduct necessary to meet the reasonable expectations of shareholders." *Id.* Neither definition requires "a showing of fraud, illegality, mismanagement, wasting of assets or deadlock although those factors are often present." *Id.*

Courts have noted the need to balance the minority shareholders' reasonable expectations against the corporation's need to exercise its business judgment and run its business efficiently. *See id.* at 289. In *Ritchie*, the defendants explained that they did not speak to potential purchasers of the minority shareholder's stock because doing so could have resulted in the purchasers suing the corporation. *See id.* at 296. The court rejected this claim finding that "The corporation's interest in managing its affairs—or to minimize the possibility of litigation—does not include the right to 'substantially defeat' a reasonable expectation of the minority shareholder that she can effectively market her unrestricted stock…." *Id.*

Some courts have stated that the allegedly oppressive conduct must not be protected by the business judgment rule. *See In re Mandel*, 2011 WL 4599969 at *23; *In re White*, 429 B.R. at *213. The business judgment rule protects directors from personal liability for actions in operating the corporation unless their actions are ultra vires or tainted by fraud. *See Ritchie*, 339 S.W.3d at 295. That rule only applies to directors; it does not apply to a suit against a controlling shareholder for his actions as controlling shareholder. *See id.* at *295-96. Nonetheless, disagreements over corporate policy typically will not support an oppression claim. *See Allchin v. Chemic, Inc.*, 2002 WL 1608616 at *9 (Tex. App.−Houston [14th Dist.] Jul. 18, 2002, no pet.).

Determining whether shareholder oppression has occurred is a two-step process. The jury decides whether certain conduct occurred but the court decides whether the conduct constitutes oppression. *Ritchie*, 339 S.W.3d at 289; *Allchin v. Chemic, Inc.*, 2002 WL 1608616 at *6; *Willis v. Bydalek*, 997 S.W.2d 798, 801 (Tex. App.—Houston [1st Dist.] 1999, pet. denied); *Davis*, 754 S.W.2d at 38.

## III. WHO CAN BRING A SHAREHOLDER OPPRESSION CLAIM?

It should go without saying that one must be a shareholder to bring a stockholder oppression claim. But that can be an issue. In *Coates v. Parnassus Systems, Inc.*, 2002 WL 534595 *1 (Tex. App.—Austin Apr. 11, 2002, no pet.), the trial court granted a summary judgment against oppression claims because the consideration for the shareholder's acquisition of his shares—future services—was insufficient. The court of appeals reversed, finding a fact issue as to whether future services were a part of the consideration. *Id.*

In addition, an oppression claim is not a derivative claim; it belongs to the shareholders individually. In *Gonzalez v. Greyhound Lines, Inc.*, 181 S.W.3d 386, 393 (Tex. App.−El Paso 2005, no pet.) the court found that the plaintiffs had sued as limited partners, and not derivatively or individually. And the wrong limited partnership sued, not the one that held stock in the company. Therefore, plaintiffs could not maintain their stockholder oppression claims.

Further, according to one court, a "stockholder oppression [claim] is generally not available to a 50% owner." *Allchin v. Chemic, Inc.*, 2002 WL 1608616 at *7. The Allchin court recognized that a 50% shareholder who dominates control could be subject to a stockholder oppression claim but found that the evidence of control was lacking in that case. *See id.* at *7-8.

One Texas court has held, without citing any authority, that a party who received all her shares as a gift or bequest could not show oppression under the first definition based reasonable expectations. *See Guerra v. Guerra*, ___S.W.3d___, 2011 WL 3715051 * 6 (Tex. App.—San Antonio, Aug. 24, 2011). The *Guerra* court did not provide any analysis to support this holding, and it is questionable. In fact, the holding is contrary to the views of Professor Doug Moll discussed in the very article the court cites. Professor Moll examined several possible positions on whether the shareholder oppression doctrine applies to minority shareholders who acquired their shares without investing, such as through gift or bequest. *See* D. Moll, <u>Shareholder Oppression & Reasonable Expectations: Of Change, Gifts, and Inheritances in Close Corporation Disputes</u>, 86 MINN. L. REV., 717, 763-787 (2002). He found the position that non-investing shareholders have no specific expectations to be protected—the position apparently taken by the *Guerra* court—is overly restrictive. *Id.* at 774. Instead, he concluded that "stockholders who receive their shares through gift or inheritance should be treated equivalently to stockholders who actually contribute their own capital to the venture." *Id.* at 789.

## IV. GENERAL REASONABLE EXPECTATIONS WHICH TEXAS COURTS HAVE RECOGNIZED AS THE BASIS FOR SHAREHOLDER OPPRESSION CLAIMS

### A. Suppressing dividends

Suppressing dividends is a common act of oppression in closely-held corporations, in Texas and elsewhere. *See generally* Moll at §7.01[C][4]. In fact, the seminal Texas supreme court case of *Patton v. Nicholas*, 279 S.W.2d 848, 853-54 (Tex. 1955) addressed the "malicious suppression of dividends." There Patton owned 60% and Nicholas and Parks each owned 20% of a profitable mercantile corporation. *See id.* at 850. After a dispute arose with Patton, Nicholas and Parks left their positions as employees and officers of the company. *See id.* Soon thereafter, they were not re-elected as directors; rather, the new directors included Patton's brother and later his wife. *See id* at 851.

Although the corporation stayed profitable, its net income to net sales ratio declined. *See id.* It paid no dividends in the six years after it was organized, during which time Patton received an annual salary ranging from $18,000 to $35,000. *See id.* The corporation's net worth increased, as did its inventory. *See id.* Nicholas and Parks, however, received nothing after they resigned their employment. *See id.*

After considering all the circumstances, the court found that Patton intended to eliminate plaintiffs from every connection with the business by not paying dividends even though the company was increasing its surplus at almost 10% a year. *See id.* The Court sustained the jury's finding of malicious suppression of dividends. *See id.* at 854.

In another often-cited case, the plaintiffs in *Davis v. Sheerin* contended, but the jury failed to find, that the controlling shareholder had maliciously suppressed dividends. *See* 754 S.W.2d at 378.

The plaintiff in *Gibney v. Culver*, 2008 WL 1822767 * 2-4 (Tex. App.−Corpus Christi, Apr. 24, 2008, pet. denied) claimed, but the jury failed to find, that the controlling shareholder had wrongfully withheld dividends. The court of appeals affirmed this verdict based on evidence that the complaining shareholder had received over $400,000 in stock-related payments during the time he complained there were no shareholder dividends so he was not singled out or oppressed. *See id.* at *17-18.

The court in *Redmon v. Griffith* found that the allegation that the Griffiths had maliciously suppressed dividends owed to the Redmons stated a claim for stockholder oppression. *See* 202 S.W.2d at 235. The court did not discuss the specific evidence of how dividends were suppressed but reversed a summary judgment against the oppression claim. *See id.*

Similarly, the plaintiff in *Advanced Marine, Inc. v. Kelley*, 1991 WL 114463 *1 (Tex. App.−Houston [1st Dist.] June 27, 1991, no pet.) contended that the majority shareholder had oppressed her by paying inadequate dividends. The case does not discuss the evidence to support that claim because the defendant did not preserve error. *See id.*

In *Duncan v. Lichtenberger*, 671 S.W.2d 948, 950 (Tex. App.—Fort Worth 1984, writ ref'd n.r.e.) the majority shareholder, Duncan, totally controlled the corporation's business, a nightclub. He fired the minority shareholders from their jobs with the club and excluded them from management. *See id.* Afterwards the corporation never paid dividends because Duncan claimed to be remodeling the club, leaving no money available. *See id.* at 951. The jury found that Duncan breached his fiduciary duties to the minority shareholders. The court of appeals observed that the officers and directors owe fiduciary duties to the corporation and that equitable relief is available for breach of fiduciary duty. *Id.* It cited *Patton* finding that malicious oppression of dividends was akin to breach of trust. *Id.* at 953.

Similarly, the plaintiff in *Pinnacle Data Services Inc. v. Gillen*, 104 S.W.3d 188, 196 (Tex. App.−Texarkana 2003, no pet.) claimed that the majority stockholder had committed oppression by wrongfully withholding profit distributions, among other things. But because plaintiff failed to raise a fact issue on that claim the trial court's no evidence summary judgment was affirmed. *See id.*

The court in *Bulacher v. Enowa, LLC,* 2010 WL 1135958 *2 (N.D. Tex., Mar. 23, 2010) found that an allegation that the controlling shareholders used prepaid consultant fees to artificially lower the company's earnings and thereby reduce the plaintiff's quarterly income, among other allegations, stated a claim for stockholder oppression.

In *In re White* Richard White purchased 8% of Four Seasons Equipment, Inc. and worked as a salesman. *See* 429 B.R. at 205. He was ultimately fired for making derogatory comments about the company. *See id.* at 205-06. After his termination, the company became very successful. *Id.* at 207-08. But in a remarkably blatant attempt to avoid paying taxes, it paid bonuses to its stockholders/employees as a means of distributing out its profits. *See id.* at 207-08. Thus, once White stopped being an employee, he could not share in the profits although he remained a shareholder. *See id.* at 207-11. The court found that paying out large bonuses to shareholders/employees but not paying dividends was oppressive. *See id.* at 214. It concluded that "[a] corporation that operates in a manner intended to deprive a shareholder with reasonable expectations to share in the corporation's profits is operating in an oppressive manner." *See id.* It noted that sharing in the corporation's profits is one of a shareholder's "fundamental expectations." *Id.*

### B. Trying to deprive a minority shareholder of his stock

Several Texas cases have found attempts to deprive the minority of their stock in some fashion oppressive. For instance, in *Davis v. Sheerin*, when Sheerin, a 45% owner, demanded to inspect the corporate books Davis, the 55% owner, claimed that Sheerin had given Davis his stock. *See* 754 S.W.2d at 377-78. The jury found that Davis had conspired to deprive Sheerin of his stock. *Id.* at 378. In addition to relying on the jury findings, the trial court considered undisputed evidence that Davis claimed Sheerin had given him his stock even though the corporate records clearly showed Sheerin as a 45% stockholder and Davis' son had tried to buy Sheerin's stock after the time at which Davis claimed it had been given to him. *See id.* at 383.

The plaintiff in *Coates v. Parnassus Systems, Inc.* claimed that the company failed to issue stock certificates to him. *See* 2002 WL 534595 at*1. The trial court granted summary judgment against the claim because Coates' consideration for his shares—future services—was insufficient. *Id.* The court of appeals reversed, finding a fact issue as to whether future services were part of the consideration for the stock. *See id.*

As discussed under Section V below, the controlling shareholder in *Cotten v. Weatherford Bancshares, Inc.*, 187 S.W.3d 687, 694-95 (Tex. App.—Fort Worth 2006, pet. denied), attempted, through a sham redemption, to acquire the stock of a lone holdout who refused to sell. Although the court could have found that this conduct violated the shareholder's reasonable expectations, it instead characterized it under the second prong of oppression—burdensome, harsh, or wrongful conduct. *See id.* at 700-01.

The controlling shareholders in *Ritchie v. Rupe* did not deny that the minority owner owned stock. But they refused to meet with prospective purchasers of a minority shareholder's stock. *See* 339 S.W.3d at 281-83. The trial court concluded as a matter of law that the defendants acted oppressively in refusing to cooperate with the shareholder's attempts sell her stock. *See id.* at 283. The court of appeals agreed. *See id.* at 296-97.

Several courts have indicated that attempts to buy out the minorities' stock for less than its worth could constitute oppression. In *DeWoody v. Rippley*, 951 S.W.2d 935, 938-39 (Tex. App.−Fort Worth 1997, no pet.), the defendants attempted to buy out DeWoody's stock in Cable Advertising Networks, Inc. ("CAN") for an amount they admitted was millions of dollars below what it was worth. DeWoody sued for stockholder oppression based, in part, on the defendants' attempts to defraud him out of his interest in CAN. *See id.* at 943. The opinion dealt with defendants' affirmative defenses and did not address the merits of the oppression claim.

Finally, the plaintiff in *Bulacher v. Enowa* claimed that the controlling shareholder engaged in oppressive conduct by attempting to induce him to allow the company to purchase his 17% share at a fraction of its market value. *See* 2010 WL 1135958 at *2. The court held that stated a claim for oppression. *See id.*

### C. Taking a disproportionate share of the corporation's income: disguised or de facto dividends.

Another common oppression claim is that the controlling shareholder has received a disproportionate share of the corporation's income. That conduct is sometimes referred to as receiving disguised or de facto dividends. *See generally* Moll at §7.01[C][5]. The claim has arisen in several Texas cases. For example, the jury in *Davis v. Sheerin* found that Davis had received disguised dividends by making contributions to a profit-sharing plan that excluded Sheerin. 754 S.W.2d at 382.

Paying excessive salaries or bonuses to the controlling shareholder has also supported claims for oppression. *See, e.g., In re Rosenbaum*, 2010 WL 1856344 *3-4 (Bankr. E.D. Tex. May 7, 2010), *aff'd* 2011 WL 4553440 (E.D. Tex. Sept. 29, 2011) (majority shareholders took over $600,000 out the corporation as salary and bonuses and paid few of its bills); *Bulacher* v. *Enowa*, 2010 WL 113958 at *2 (allegation of excessive bonuses to controlling shareholder stated claim for oppression); *In re White*, 429 B.R. at 209-10 (excessive bonuses as a means of distributing profits to the shareholder/employees); *Gibney v. Culver*, 2008 WL 1822767 at *12-16 (holding there was insufficient evidence to support jury's finding that controlling shareholder used his position as CEO to award excessive salaries and compensation to family members to the minority's detriment); *DeBord v. Circle Y of Yoakum, Inc.*, 951 S.W.2d 127, 129-30 (Tex. App.−Corpus Christi 1997), *rev'd on other grounds* 967 S.W.2d 352 (Tex. 1998) (claim that directors paid themselves excessive salaries); *Gibbons Mfg. v. Milans*, 17 S.W.2d at 845 (excessive salary paid to 52% shareholder was one of several allegations that warranted receiver).

Using corporate funds or assets for his personal benefit is another means by which a controlling shareholder may receive a disproportionate share of the corporation's earnings and may support oppression claims. *See, e.g., In re Rosenbaum*, 2010 WL 1856344 at *3-4 ("The Rosenbaums' conduct was certainly 'oppressive' inasmuch as their practice of transferring substantially all of Cornerstone's assets to themselves defeated Gage's expectations which, when objectively viewed, were both reasonable under the circumstances and central to his decision to purchase shares in Cornerstone."); *Pinnacle Data Services Inc. v. Gillen*, 104 S.W.3d at 196 (oppression claim based on controlling shareholder having the company pay their personal legal fees); *Redmon v. Griffith*, 202 S.W.3d at 235 (allegation that 75% shareholder made improper personal loans to themselves in addition to paying personal expenses with corporate funds without board approval); *Advance Marine Inc. v. Kelley*, 1991 WL 114463 at *1 (controlling shareholders oppressed minority by using corporate funds to take non employees to boat shows); *Gibbons Mfg. v. Milans*, 17 S.W.2d at 845 (52% owner had company pay his car expenses).

### D. Conflict of interest transactions.

In addition to taking a disproportionate share of the corporation's earnings, a controlling shareholder may also benefit himself to the detriment of the corporation and the other shareholders by engaging in self dealing and other conflict of interest transactions. *See generally*, Moll at §7.01[C][6]. Moll gives the follow examples of conflict of interest transactions:

i. Using the corporations' non-cash assets, without fair compensation, for personal purposes;
ii. Usurping corporate opportunities;
iii. Borrowing money from the company at below market rates of interest; and
iv. Buying or leasing property from the corporation at below market prices.

*Id.* at p. 7-47.

Such claims have arisen in Texas. For example, in *In re Mandel* the director/shareholder (Mandel) shut down the company, took its intellectual property and formed a new entity to engage in the same business—attempting to develop a new internet search engine. *See* 2011 WL 4599969 at *1-10. The court found that Mandel's usurpation of business opportunities also constituted shareholder oppression. *Id.* at *23.

In *Christians v. Stafford*, ___S.W.3d___, 2000 WL 1591000 *1 (Tex. App.—Houston [14th dist] Sep. 21, 2000, no pet.), a minority shareholder Stafford complained—and the jury found— that the majority owners, the Christians, entered lease agreements with insiders at less than fair value. (The opinion does not describe the agreements or whom they were with.) Based on that finding the trial court deemed the Christians' conduct oppressive and ordered them to buy-out Stafford. *See id.* The court of appeals agreed that a buy-out was an available remedy but found the evidence was factually insufficient to support the verdict. *See id.* at *2-3. *See also Redmon v. Griffith*, 202 S.W.3d at 235 (allegation that 75% shareholder diverted corporate opportunities); *DeBord v. Circle Y of Yoakum, Inc.*, 951 S.W.2d at 129-30 (allegation that shareholder/directors usurped corporate opportunities).

Although no reported Texas opinion has directly addressed the issue, a controlling shareholder who engages in a transaction in which he is on opposite sides from his corporation should not have the benefit of the business judgment rule. Under that doctrine, courts typically do not second guess a corporation's business judgments made without fraud even if they turn out to be ill advised. But in a self-dealing situation the controlling shareholder can uphold the transaction (and avoid liability) only if he "establish[es] that the transaction withstands the closer scrutiny of the entire fairness test." Moll at 6-182.

After reviewing the pertinent cases, Professors Moll and Ragazzo summarize the law as follows:

> It is important to observe that a transaction between a controlling shareholder and his corporation will always trigger an entire fairness standard of review. After all, when the controlling shareholder and the corporation are on opposite sides of a transaction, there is always a disproportionate benefit, as the controlling shareholder is, by definition, getting something from the corporation (the subject matter of the transaction) that the minority shareholders are not. …Thus, just like when a director or officer is contracting with his corporation, a transaction between a controlling shareholder and his corporation always raises the specter of a conflict of interest and should correspondingly invoke the greater scrutiny of the entire fairness standard.

*Id.* at 6-186.1-187.

**E. Refusing access to corporate financial information.**

Oppression claims frequently include the controlling shareholders denying the minority shareholders access to company information. *See generally* Moll at § 7.01[C][3]. Section 21.218 of the Texas Business Organization Code allows a stockholder with at least 5% of the outstanding shares to examine and copy the corporation's relevant books, records of accounts, minutes, and share transfer records for a proper purpose. Given this statutory right, a shareholder in a closely-held corporation—at least one holding at least 5% of the stock—would seem to have a general expectation to a right to information. But some courts have treated an oppression claim based on denial of information as falling under the second definition of burdensome, harsh and wrongful conduct. *See, e.g., Gibney v. Culver*, 2008 WL 18227667 at *18-19. In *Gibney*, the court of appeals held that the evidence supported the finding that the controlling shareholder did not maliciously or wrongfully prevent Gibney from inspecting the company's books and records because the record did not contain any documentation reflecting the desire and stating a proper purpose in compliance with the statute. *See id.*

Of course, given the statutory right to an inspection, a shareholder can sue for access to the books and records without framing it as an oppression claim. *See, e.g., Spike S Ranch, Inc. v. Foreign Trade and Management, SA*, 2000 WL 1038165 *3-4 (Tex. App.—El Paso, Jul. 27, 2000, no pet.) (stockholder obtained temporary restraining order requiring director to produce documents and records regarding past sales and conveyances of the corporation's assets, as well as bank records); *Redmond v. Griffith*, 202 S.W.3d at 231-32 (stockholder sued for an accounting and inspection of corporation's books and records). But a refusal to provide access to corporate information can also be the basis for an oppression claim. *See Bulacher v. Enowa*, 2010 WL 1135958 at *2 (allegation that defendants prevented minority shareholders the access to critical financial and business information supported claim for stockholder oppression).

Perhaps the best example is *Duncan v. Lichtenberger*. There, after securing majority control, Duncan began to conduct board meetings and shareholder meetings without notifying the shareholders who had been on the board. The court found that this conduct, among other acts, supported a breach of fiduciary duty finding, and affirmed the trial court's remedy: restoration of the plaintiff's consideration for their stock. *See* 671 S.W.2d at 950-53.

## V. SPECIFIC REASONABLE EXPECTATIONS WHICH TEXAS COURTS HAVE RECOGNIZED AS THE BASIS FOR SHAREHOLDER OPPRESSION CLAIMS

**A. Firing the minority shareholders from their jobs with the corporation.**

An employee of a publicly traded company that also owns stock in the company usually has a separate economic interest in his employment from that in his stock. *See* Moll at p. 7-27. If she likes her job but thinks that the stock is a poor investment, she can simply sell the stock. Conversely, if she quits or is fired, but still thinks the stock is a good investment, she can keep it. *See id.*

In a closely-held corporation, however, the economic interest in stock ownership is often closely tied to employment. *See id.* In fact, many investors may decide to invest in a closely-held corporation due to the benefits of employment. *See id.* The risk of investing in a closely-held corporation—especially startups—is significantly higher than investing in a public company. The benefits of employment often compensate for that additional risk. *See id.* at 7-28-29.

Consequently, oppression claims often involve termination of a minority stockholder's employment. And even though a minority stockholder who is an at-will employee might not have a breach of contract claim, his firing could still constitute shareholder oppression. *See, e.g.*, *Redmon v. Griffith*, 202 S.W.3d at 238-39 (termination of the Redmons' employment could be a part of their stockholder oppression claim but would not support a breach of contract claim).

An example of such a claim is the *Duncan v. Lichtenberger* case. There, Duncan acquired 60% ownership of a corporation that operated a nightclub and promptly fired the minority shareholders from their employment positions. 671 S.W.2d at 950. He even falsely told the club manager that he had a temporary restraining order against them and they were not allowed on the premises, even though he did not have one. *See id.* There, the court found that this conduct and other conduct supported a breach of fiduciary duty claim.

The minority shareholder *In re White* also claimed his termination of employment was oppressive. But although the court found stockholder oppression based on disguised dividends, it did not find his termination to be oppressive. Rather, it accepted the trial court's finding that he had been terminated because he was disrupting the work environment. *See* 439 B.R. at 205-6 and 214.

The plaintiff in *Allchin v. Chemic, Inc* claimed he was forced to resign as a result of the controlling shareholder's conduct. 2002 WL 1608616 at *9. But he testified that he left voluntarily because he had found another job. *Id*. The court of appeals commented that "[a]n employee who voluntarily leaves the employment of the corporation presents a less persuasive case for concluding the majority shareholders oppressed him."

**B. Preventing the minority from participating in management.**

Similarly to expecting employment, investors in closely-held corporations often have an expectation of participating in management. *See* Moll at §7.01 [C][2]. In addition to the possible prestige and other intangibles arising from holding a director or officer position, participating in management also allows a shareholder to effectively monitor his investment—something very important in the closely-held context. *See id.* at p. 7-33-34. Denying the ability to participate in management is often part of an oppression claim.

Again, the *Duncan v. Lichtenberg* case provides a good example. There, in addition to firing the minority shareholders from their employment positions, Duncan excluded them from board and shareholder meetings by not even notifying them of the meeting. *See* 671 S.W.2d at 951. The court found that this conduct, among other acts, constituted a breach of fiduciary duty to the minority shareholders. *Id.*

## VI. OTHER BURDENSOME, WRONGFUL CONDUCT WHICH TEXAS COURTS HAVE RECOGNIZED AS A BASIS FOR SHAREHOLDER OPPRESSION CLAIMS

As the *Ritchie* court noted, the standards of fair dealing under the second definition of oppression will often overlap with the reasonable expectations under the first definition "because the standards of fair dealing on which all shareholders are entitled to rely will often be conduct necessary to meet the reasonable expectations of all shareholders." *See Ritchie v. Rupe*, 339 S.W.3d at 292. For example, in *Gibney v. Culver*, the court characterized the refusal to provide access to corporate financial information as falling under the burdensome, harsh, or wrongful definition. *See* 2008 WL1822767 at *18-19. It found that this refusal was not burdensome, harsh, and wrongful because Gibney had never properly asked to inspect the records. *See id.*

In *Cotten v. Weatherford Bancshares, Inc.*, 187 S.W.3d 687, 694-95 (Tex. App.—Fort Worth, 2006, pet. denied), Sharp sought to acquire complete ownership of a bank, which was owned through a series of holding companies. Cotten also held common stock and refused to sell to Parker. *See id.* Sharp then acquired all the stock of the top-tier holding company through an involuntary merger. *See id.* But Cotten still owned preferred shares of stock in an intermediate holding company, which owned 99.3% of the local bank. *See id.*

The bylaws apparently allowed the corporation to redeem some but not all of the preferred shares pursuant to a random drawing. Sharp and his daughter claimed to have had a "secret" random drawing in which, miraculously, all of Cotten's preferred shares were drawn. *See id.* at 695-97. The court found that Sharp and his daughter's improper redemption of the preferred shares gave them a financial benefit and thus raised a fact issue of oppression under the second definition—burdensome, harsh, or wrongful conduct. *See id.* at 700-01.

In *DeBord v. Circle Y of Yoakum, Inc.*, the minority shareholders contended that directors had incurred costs and expenses in a phantom merger, failed to supervise employees and instituted control to prevent embezzlement, among other things. *See* 951 S.W.2d at 129-30. Presumably, those fell under the second definition.

In *Devji v. Keller*, 2000 WL 1862819, *5-7 (Tex. App.−Austin, Dec. 21, 2000, no pet.) the court found that the following evidence supported the jury's answer that the majority shareholder, Devji, engaged in oppressive conduct under the second definition:

- he regularly opposed the minority shareholders', the Kellers, efforts to sell undeveloped land to generate cash;
- he opposed the Kellers' efforts to sell the corporation's property to avoid an inevitable foreclosure;
- he insisted that the Kellers personally finance the corporation's operations and threatened them with lawsuits if they did not; and
- while he was demanding that Chris Keller pay expenses on a project and threatening to sue him if he did not, Devji was conspiring to develop properties initially acquired by the company to directly compete with the company.

Self-dealing transactions such as those discussed under section III D above could also constitute burdensome, wrongful, harsh conduct or conduct violating the standards of fair dealing.

As discussed below, in certain cases majority shareholders may owe fiduciary duties to the minorities. If so, can the breach of those duties constitute oppressions as well? At least two opinions suggest that it can. In *In re Mandel* the United States Bankruptcy Court concluded that Mandel's breaches of fiduciary duty to the company, as well as to the minority shareholders, constituted acts of shareholder oppression. *See* 2011 WL 4599969 at *23. And the *Davis v. Sheerin* court found the defendant's "willful breaches of fiduciary duty" along with other findings supported the trial court's conclusion of oppressive conduct and the likelihood that it would continue in the future. *See* 754 S.W.2d at 383.

One opinion, however, has reached a contrary conclusion. In *Allen v. Devon Energy Holdings, LLC*, ____ S.W.___, 2011 WL 3208234 (Tex. App.—Houston [1st Dist.] Jul. 28, 2011, no pet.), the court stated that neither the plaintiff Allen nor the court could find any case that extended shareholder oppression to include causes of action for fraud and breach of fiduciary duty. *See id* at *32. It further stated that the conduct Allen complained of—the majority owner's buying out a minority shareholder without disclosing information that the company was worth substantially more than the value on which the buyout price was based—was not similar to the previously recognized examples of stockholder oppression. *See id.*

The suggestion, however, that oppression claims are limited to conduct previously deemed oppressive is quite questionable given the recognition of Texas courts that oppression is a broad doctrine with no set standard. *See* discussion under section II above. A court should not let a controlling shareholder off the hook simply because he came up with a novel way of acting in a burdensome, harsh or wrongful manner that no court had yet addressed. A court should be free to determine whether conduct is burdensome, harsh, wrongful, or violates notions of fair dealing and fair play without being limited to past conduct that was found to meet those standards. Otherwise, the doctrine would never evolve.

## VII. BREACH OF FIDUCIARY DUTY CLAIMS AGAINST CONTROLLING SHAREHOLDERS

A majority or controlling shareholder does not, by virtue of that status alone, automatically owe fiduciary duties to the minority shareholders. *Allen v. Devon Energy Holdings*, 2011 WL 3208234 at *25; *Redmon v. Griffith*, 202 S.W.3d at 235 (citing *Willis v. Donnelly*, 118 S.W.3d 10, 29 (Tex. App–Houston [14th Dist.] 2003, *aff'd in part, mod'd in part, rev'd in part and rem'd in part*, 187 S.W.3d 687 (Tex. 2006)). Courts recognize that "[t]he fiduciary relationship is an extraordinary one and will not be lightly created; [and that] the mere fact that one subjectively trusts another does not alone indicate that confidence is placed in another in the sense demanded by fiduciary relationship because something apart from the transaction between the parties is required." *Redmon* at 237.

Still, depending on the facts, fiduciary duties may arise, especially in the closely-held corporation context. *Id.* at 234-35, 237; *see also DeBord v. Circle Y of Yoakum, Inc*., 951 S.W.2d at 133 ("Majority shareholders are sometimes said to stand in a fiduciary relationship both with the corporation which they control and with the minority shareholders); *Hoggett v. Brown*, 971 S.W.2d 472, 488 n. 13 (Tex. App.—Houston [14th Dist.] 1997, pet. denied) ("a majority shareholder's fiduciary duty ordinarily runs to the corporation," but "in certain circumstances, a majority shareholder who dominates control over the business may owe such a duty to the minority shareholder"). "This is especially true when the corporation is closely-held by a small number of shareholders who operate more as partners than in strict compliance with the corporate form." *DeBord v. Circle Y of Yoakum, Inc*., 951 S.W.2d at 133 (citing *Pepper v. Litton*, 308 U.S. 295 and 306-7 (1939)).

Some courts have allowed breach of fiduciary duty claims without any discussion of how the minority shareholder established that the controlling shareholder owed them an individual fiduciary duty. *See In re Mandel*, 2011 WL 4599969 at *18; *Davis v. Sheerin*, 754 S.W.2d at 378-83; *Duncan v. Lichtenberger*, 671 S.W.2d at 950-53. Other opinions give more guidance, although the question is very fact specific.

The court in *Allen v. Devon Energy* held that the purchase of a minority shareholder's interest through a redemption agreement did not create a formal fiduciary relationship as a matter of law, although it might in certain circumstances. 2011 WL 3208234 at *25. The court listed the following factors to determine whether a fiduciary relationship exists:

- The nature of the parties' relationship, including the parties' closeness and whether the relationship is a close personal friendship or business relationship;
- whether the parties' transactions were conducted at arm's length;
- the terms of any contracts between the parties and whether the purported fiduciary exercised dominance over the length of the parties' relationship or any undue influence over the other party; and
- Whether the plaintiff relied on the purported fiduciary "for moral, financial, or personal support or guidance."

*Id.* at *26-27. The court also observed that the "special relationship of trust and confidence must exist prior to, and apart from, the agreement made the basis of the suit." *Id.* at *27. The court found the following evidence sufficient to raise a fact issue on the existence of a fiduciary duty:

- Allen (the minority shareholder) and Rees-Jones (the majority shareholder) were personal friends for over twenty years and practiced law together;
- Rees-Jones told Allen he was a "founding partner" in the company and at times referred to Allen as his partner;
- Rees-Jones also agreed to a limited fiduciary duty to the company's investors under the shareholders' agreement;
- Rees-Jones' position as an insider gave him intimate knowledge of daily affairs and future plans;
- Rees-Jones was Allen's sole source of information about the company's status over the years; and
- the transaction was a repurchase of Allen's stock in a closely-held corporation.

*Id.* at *27-30.

The *Redmon* opinion suggested that oppressive conduct itself may justify the imposition of a fiduciary duty. It held that the allegations "indicating a great deal of control over the business…combined with allegations…that the Griffiths engaged in wrongful conduct and lack of fair dealing with regard to the company's affairs to the prejudice of the Redmons sufficiently allege[d] a breach of fiduciary duty by way of oppressive conduct." 202 S.W.3d at 238. Similarly, the court in *In re Rosenbaum* found that the controlling shareholders of the company, Cornerstone, owed a fiduciary duty to the minority shareholder because: "They dominated control of Cornerstone…and they did not operate Cornerstone in compliance with the corporate form. They used Cornerstone as their personal piggy bank." 2010 WL 1856344 at *8.

But oppression can exist without imposing a fiduciary duty on a controlling shareholder. *See, e.g., Cotten v. Weatherford Bancshares, Inc.*, 187 S.W.3d at 698-700 (upholding a directed verdict against the fiduciary duty claim because there was no evidence of a confidential relationship but finding the evidence supported an oppression claim). And as discussed above, a breach of fiduciary duty may or may not constitute oppression.

Perhaps the test should be as simple as that suggested by Professors Moll and Ragazzo. They observed that the law imposes fiduciary duties on directors because they have the power to control corporate affairs. *See* Moll at p. 6-179. If a controlling shareholder has that same power, then he should have the same fiduciary duties. *See id.*

## VIII. REMEDIES FOR SHAREHOLDER OPPRESSION

The Texas Supreme Court instructs that "equity will take cognizance of a controversy to determine the rights of all the parties, and grant the relief required to meet the ends of justice in order to prevent a multiplicity of suits." *Rogers v. Daniel Oil & Royalty Co.*, 110 S.W.2d 891, 895-96 (Tex. 1937) (recognizing that equity jurisdiction can "interfere to prevent a multiplicity of suits"). A court's equitable powers to fashion relief are broad. Without limiting that broad power, some of the remedies, which Texas courts may employ to redress oppression, are discussed below.

### A. Receivers

Section 11.404 of the Texas Business Organizations Code allows a court to appoint a receiver to rehabilitate an entity when "the actions of the governing persons of the entity are illegal, oppressive, or fraudulent." That section as well as section 11.403 (receivers for particular property) also allow courts to appoint receivers in actions in which courts of equity have traditionally appointed receivers.

The San Antonio Court of Appeals has recognized the need to appoint a receiver when preservation of the corporation's property is at risk. *See Berkshire Petroleum Corp. v. Moore*, 268 S.W. 484, 485-486 (Tex. App.—San Antonio 1924, no writ; *see also, Aubin v. Territorial Mortgage Co. of America, Inc.*, 640 S.W.2d 737, 740-41 (Tex. App.—Houston [14th Dist.] 1982, no writ (upholding appointment of receiver under article 7.05 and *Berkshire*).

The Supreme Court in *Patton v. Nicholas* concluded that in the extreme case like the one before it a Texas court could, under its general equity powers, decree liquidation and appoint a receiver. *See* 279 S.W.2d at 856-57. The *Patton* Court opted for a lesser remedy in that case. Texas courts, however, have appointed receivers where the conduct of the controlling shareholder put the corporation at risk. In *Gibbons Mfg. v. Milan*, for example, the 52% shareholder of a wagon manufacturer:

- dictated the management of the corporation;
- neglected its business;
- refused to follow the board's instructions;
- ultimately placed himself in control of the board;
- closed a manufacturing plant allowing its extensive and valuable machinery to remain idle;
- sold the corporation's timber which was supposed to be used in the company's manufacturing facility, for below-market value;
- charge his personal car expense to the company;
- paid himself an excessive salary; and
- paid himself a dividend out of the company's surplus when the company had lost money.

*See* 17 S.W.2d at 844-46. Citing the doctrine that allows a minority shareholder to sue for the majority shareholder's oppressive conduct, the court found that the allegations warranted a receiver. *See id.* at 846-47. But the trial court should not have appointed one without notice. *See id.* at 847.

Although not denominated a shareholder oppression case, the court in *Pouya v. Zapa Interests, Inc.*, 2007 WL 2462001 (Tex. App.—Austin Aug. 31, 2007, pet. denied) appointed a receiver in a shareholder disputes to avoid multiplicity of suits.

### B. Special agents and advisors

Authority in other jurisdictions allows the appointment of special property advisors and special fiscal agents who have less power than a receiver. *See Republic of the Philippines v. New York Land Co.*, 852 F.2d 33, 35 (2d Cir. 1988) (in property ownership dispute court ordered a special property advisor to advise the court as to the propriety of expenditures and management of the properties at issue but advisor did not take possession of properties and was not a receiver); *Leone v. Associated Packaging, Inc.*, 795 F.Supp. 117, 121-122 (D.N.J. 1992) (court appointed special fiscal agent to permit close supervision without intrusion of a receiver); *Holi-Rest, Inc. v. Trelor*, 217 N.W.2d 517, 527 (Iowa 1974) (court appointed special fiscal agent to take control of corporation and its financial affairs to protect rights of corporation and its shareholders).

### C. Forced buy-outs

Other potential equitable remedies include a forced buy-out of a minority shareholder. *See Davis v. Sheerin*, 754 S.W.2d at 384 (holding that because art. 7.05 allowed the appointment of a liquidating receiver, a court in equity could always provide a less drastic remedy such as a buy-out). In fact, a buy-out appears to be one of the most requested remedies. *See, e.g., In re White*, 429 B.R. at 215 (complaining shareholder requested forced buyout); *Ritchie v. Rupe*, 339 S.W.3d at 300 (same); *Flores v. Star Cab Co-Op Ass'n, Inc.*, 2008 WL 3980762 *1(Tex. App.−Amarillo, Aug. 28, 2008, pet. denied) (same); *Allchin v. Chemic, Inc.*, 2002 WL 1608616 at *9 (same); *Christians v. Stafford*, 2000 WL 1591000 at *2-3(same).

There are two types of valuations for a buy-out: enterprise value, which does not include a discount for minority status or lack of marketability, and fair market value, which does. *See Ritchie v. Rupe*, 339 S.W.3d at 300. The *Ritchie* court noted that enterprise value was the appropriate valuation method 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. *Id.* at 301 (citing Moll). But that was not the case there, because the minority shareholder desired to leave the corporation and sought to market the stock. *Id.* Therefore the trial court should have provided the relief based on sale of the fair market value. *Id.*

### D. Injunction to require dividends and continuing jurisdiction to enforce it.

The Texas Supreme Court approved of a mandatory injunction and continuing jurisdiction to require the corporation to take certain steps to protect the abused minority shareholder. *See Patton*, 279 S.W.2d at 857-58 (entering decree requiring corporation and controlling shareholder to declare and pay reasonable dividends going forward).

### E. Requiring Defendant to elect the less-intrusive remedy

One court even required the defendant to elect which of two remedies it preferred. Relying on the Texas Supreme Court's *Patton* opinion, the Southern District's Bankruptcy Court noted two principles underlying the proper remedy: the remedy must provide full relief to the plaintiff (White) and the full relief should impose the smallest possible burden on the defendant (Four Seasons). *In re White*, 429 B.R. at 215-16. The court suggested two remedies: a buyout of White's 8% interest or a *Patton*-type injunction requiring the corporation to declare and pay dividends. Because the court could not determine which of the two remedies was the least onerous on the corporation, it required Four Seasons to elect between them. *Id.* at 216-19.

### F. Rescission

Although it described the claim as one for breach of fiduciary duty, not oppression, the *Duncan v. Lichtenberger* court affirmed the trial court's remedy of restoration of the plaintiff's consideration for their stock. *See* 671 S.W.2d at 950-53.

### G. Damages

As seen, most of the remedies courts have imposed for stockholder oppression are equitable. The question remains whether a stockholder oppression claim can support damages. The opinion in *Faour v. Faour*, 789 S.W.2d 620 (Tex. App.−Texarkana 1990, writ denied) suggests not. There, the corporation sued a minority shareholder to recover a debt. The shareholder counter-sued for the president's breach of fiduciary duty and to recover unpaid salary. *See id.* at 621. The shareholder contended he was entitled to damages for malicious suppression of dividends, citing *Patton v. Nicholas*. The court of appeals characterized *Patton* as authorizing an injunction where dividends had been suppressed but not holding that an individual shareholder could recover damages for dividends not paid. *See id.* at 622. The court noted that unlike stockholder oppression cases the suit before it was not an equitable proceeding. *See id.* at 623.

The bankruptcy court in *In re Mandel*, however, suggests that damages could be available for stockholder oppression. In that case, though, the damages for stockholder oppression were the same as damages for misappropriation of intellectual property and trade secrets. *See* 2011 WL 4599969 at *24.

## IX. CONCLUSION

A majority or controlling interest in a corporation does have its privileges. A controlling shareholder should have a greater say in management and policy decisions. All too often, however, a controlling shareholder believes that his control equates to unfettered power to do whatever he wants, with the minority shareholders powerless to do anything about it. The shareholder oppression doctrine in Texas is the common-law's response to abuses of power by controlling shareholders. It is—and should be—a flexible doctrine that allows courts to assess when certain conduct is oppressive and to fashion appropriate remedies.

As long as people have power, people, or at least some of them, will abuse it. Because some of the people abusing power are controlling shareholders we will see more and more shareholder oppression cases in Texas and elsewhere. And with more reported cases the doctrine will continue to evolve and better draw the line between legitimate exercise of majority control and unfair oppression.



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