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Fair Treatment of Minority Ownership Interests: Legal Developments, Fiduciary Duties, and Ethical Considerations

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I. THE FRAMEWORK

This paper concerns the legal rights and duties of business owners with an emphasis on issues relating to minority ownership interests in private Texas companies. Initially, the article focuses on limited partnerships before concluding with a discussion of issues related to minority held ownership interests in private Texas corporations or LLC's.

Limited Partnerships are typically created by a written agreement in accordance with the provisions of Texas statutes, but fiduciary duties are also imposed on general partners under common law. In a typical case, the Texas Supreme Court held that the relationship between partners "is fiduciary in character, and imposes upon all participants the obligation of loyalty to the joint concern and of the utmost good faith, fairness, and honesty in their dealings with each other with respect to matters pertaining to the enterprise." *Bohatch v. Butler & Binion*, 977 S.W.2d 543, 545 (Tex. 1998); *Lifshutz v. Lifshutz, 2006 WL 1080244 (Court App. –San Antonio, 2006, no pet.); Hughes v. St. David's Support Corporation,* 944 S.W.2d 423, 426 (Tex.App.—Austin 1997, r'hrg overruled).

A. Recent Statutory Revisions

a. Texas Business Organization Code governs Texas limited partnerships formed on or after January 1, 2006. V.T.C.A., BUS. ORG. CODE § 402.001 ("BOC")

The TBOC became effective for all newly filed domestic (Texas) business entities as of January 1, 2006, and will apply to all business entities by January 1, 2010. Existing entities can opt in to coverage before January 1, 2010 by filing an election with Secretary of State. Foreign companies that qualify to do business in (and register in) Texas are subject to the TBOC.

b. Few Substantive Changes were made in BOC to the Provisions of the Texas Revised Limited Partnership Act.

Few substantive changes were made when the legislature adopted the Texas Business Organizations Code, because the goal was to create an integrated statutory code that would modernize and simplify terms and filing procedures applicable to most Texas business entities, *e.g*., corporations, limited liability companies, partnerships and professional companies. The Code also sets forth a separate section for each type of business entity.

The few substantive changes include new requirements for holding meetings and notices and there are increased filing fees. Entities have either owners or members, which correspond to ownership interests or membership interests.

II. THE DUTIES OF GENERAL PARTNER

A. Statutory Duties

The general partner's duties of loyalty, care, and good faith are all prescribed by the Texas Business Organization Code. *See* BOC 152.204 and *see also* TRLPA 6132.(b)-4.04. These statutes describe a General Partner's duties of loyalty and care as follows:

> ***Section 152.205. Partner's Duty of Loyalty.*** A general partner's duty of loyalty includes:
>
> (1) accounting to and holding for the partnership property, profit, or benefit derived by the partner:
>
> > (A) in the conduct and winding up of the partnership business; or
> > (B) from use by the partner of partnership property;
>
> (2) refraining from dealing with the partnership on behalf of a person who has an interest adverse to the partnership; and
>
> (3) refraining from competing or dealing with the partnership in a manner adverse to the partnership.

Section 152.206. Partner's Duty of Care.

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

(b) An error in judgment does not by itself constitute a breach of the duty of care.

(c) A partner is presumed to satisfy the duty of care if the partner acts on an informed basis and in compliance with Section 152.204(b) (requiring a partner to discharge duties in good faith and in a manner the partner reasonably believes to be in the best interest of the partnership).

The Texas Business Organization Code and the Texas Revised Partnership Act do not use or reference the term "fiduciary." Further, the bar committee's comments on the Texas Revised Partnership Act indicate that the legislature intended the omission to signal a departure from the loose fiduciary concepts that arise in case law in discussions of partnership duties. *See* TEX. REV. CIV. STAT. ANN. art. 6132b, § 4.04 (Vernon Supp. 2004) (bar committee comment).

Despite the legislature's efforts to rid Texas partnership law of fiduciary conceptions of partnership duties, Texas courts continue to regard partners as fiduciaries. *See Harris v. Archer*, 134 S.W.3d 411, 431 (Tex. App.—Amarillo 2004, no pet.); *Long v. Lopez*, 115 S.W.3d 221, 223 (Tex. App.—Fort Worth 2003, no pet.). There is no indication that this will change in light of the legislature's adoption of the Texas Business Organization Code, which did not materially change the statutory language pertaining to the duties of a General Partner.

B. Common Law Duties

The General Partner's duties of loyalty, care, and good faith prescribed by statute are also recognized in the case law, but the duty of candor is additional duty that has long been upheld in Texas case law.

“Since each is the confidential agent of the other, each has a right to know all that the others know, and each is required to make full disclosure of all material facts within his knowledge in any way relating to the partnership.” *Johnson v. Peckham*, 120 S.W.2d 786, 787-88 (Tex. 1938); *Huie v. DeShazo*, 922 S.W.2d 920, 923 (Tex. 1995). A breach of the partner’s duty to fully disclose is tantamount to fraudulent concealment. *See Willis v. Maverick*, 760 S.W.2d 642, 645 (Tex. 1988); *Bright v. Addison*, 171 S.W.3d 588, 597 (Tex.App.—Dallas 2005, r’hrg overruled).

C. Tension Between Statute and Common Law

1. Statutory Provisions Regarding Scope of Partner’s Duties/Liability

“A partner does not violate a duty or obligation under this chapter or under the partnership agreement merely because the partner’s conduct furthers the partner’s own interest. A partner, in the partner’s capacity as partner, is not a trustee and is not held to the standards of a trustee.” BOC Section 152.204 (c and d) and TRLPA 6132b –4.04 (e and f).

2. Common Law Standard

Courts continue to hold, however, that general partners, particularly managing general partners, owe stringent fiduciary duties to other partners and the partnership. “A managing partner owes his partners the highest fiduciary duty recognized in the law.” *Brosseau v. Ranzau, 81 S.W.3d 381,395 (Civ. App. --Beaumont 2002, writ denied)* citing *Huffington v. Upchurch, 532 S.W.2d 576, 579 (Tex. 1976).*

> It is well established that partners are charged with a fiduciary duty. Managing partners owe their copartners the highest fiduciary duty recognized in the law. Furthermore, in a limited partnership, the general partner stands in the same fiduciary capacity to the limited partners as a trustee stands to the beneficiaries of a trust. Among the duties that a partner owes its co-partners is the duty of full-disclosure of all matters affecting the partnership. In a limited partnership, the general partner owes the same duty of full disclosure to the limited partners.

Hughes v. St. David's Support Corp., 944 S.W.2d 423, 425-26 (Tex. App. –Austin 1997, writ denied).

III. STATUTORY/CONTRACTUAL LIMITATIONS OF LIABILITY

Limited partnership agreements routinely include contractual provisions designed to limit the liability of general partners and officers. These limitations are often broadly worded in a manner designed to preclude liability for negligence or any act or omission made in good faith reliance on information or advice provided by the limited partnership's financial or legal professionals, such as the following:

> "Neither the General Partner nor any of its officers, directors or employees shall be liable, responsible or accountable in damages or otherwise to the Partnership or to the Limited Partners for any act or omission performed or made by any of them in the capacity as a General Partner or any other capacity in which any of them act at the request of the Partnership or otherwise if such Person acted reasonably in a manner he believed to be in, or not opposed to, the best interests of the Partnership and was not guilty of gross negligence or willful misconduct with respect to such act or omission. In particular, the General Partner, its officers, directors, and employees shall not be so liable, responsible or accountable for a any allocation, distribution or other act or omission performed or made by them in good faith reliance on financial statements of the Partnership reported on by independent certified public accountants or for any act or omission performed or made by them in good faith reliance on advice of legal counsel. Neither the General Partner nor any of its officers, directors, or employees shall be liable, responsible or accountable in damages or otherwise to the Partnership or to the Limited Partners for any act or omission if such Person shall have been merely negligent, with respect to such act or omission."

It is unclear whether such contractual limitations of liability (or even broader exculpatory clauses) are permissible under applicable Texas law (*i.e.*, whether they will be upheld by the courts). BOC Section 153.152 provides that, "except as provided by this chapter, the other limited partnership provisions, ***or a partnership agreement***, a general partner of a limited partnership…has the liabilities of a partner in a partnership without limited partners to the

partnership and to the other partners" (emphasis added). BOC Section 152.002 (applicable to general partnerships -- without limited partners) provides that partnership agreements **may not:**

(1) unreasonably restrict a partner's right of access to books and records under Section 152.212;

(2) eliminate the duty of loyalty under Section 152.205, except that the partners by agreement may identify specific types of activities or categories of activities that do not violate the duty of loyalty if the types or categories are not manifestly unreasonable;

(3) eliminate the duty of care under Section 152.206, except that the partners by agreement may determine the standards by which the performance of the obligation is to be measured if the standards are not manifestly unreasonable;

(4) eliminate the obligation of good faith under Section 152.204(b), except that the partners by agreement may determine the standards by which the performance of the obligation is to be measured if the standards are not manifestly unreasonable; and

(5) vary the power to withdraw as a partner under Section 152.501(b)(1), (7), or (8), except for the requirement that notice be in writing.[1]

There is an argument that statutory restrictions limiting the scope of a general partner's duties of loyalty, care, and good faith do not apply at all to limited partnership agreements, because BOC Section 153.152 makes chapter 152 applicable to limited partnership's "except as provided by…a partnership agreement." It does not appear, however, that any court has held that a partnership agreement can disregard the statutory prohibitions against limiting or eliminating certain duties of a General Partner. As a result, drafters of partnership agreements must navigate the interplay between case authorities that predate the Texas Business Organization Act, the Texas Revised Limited Partnership Act, and the Texas Revised Partnership Act, and cases interpreting similar provisions in the context of Texas trust law.

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[1] Similar restrictions on the ability to modify the duties of care, loyalty, and good faith are included in the Texas Revised Partnership Act, and made applicable to limited partnerships by the Texas Revised Limited Partnership Act. Vernons's Ann. Civ. St. art. 6132a-1, § 4.03(b); Vernon's Ann. Civ. St. art. 6132b-1.03(b)(1)-(5).

In *Grider v. Boston Co., Inc*., a Texas appellate court (before adoption of the BOC) the limited liability provisions of a limited partnership agreement that provided the general partner with unrestricted authority and discretion to expend partnership funds without liability absent willful malfeasance or fraud. *Grider*, 773 S.W.2d 338 (Tex. App.—Dallas 1989, writ denied). The court held, relying on trust law, that parties with equal bargaining power may contract for the limitation of a fiduciary's liability, but the court limited this broad discretion by stating that "public policy precludes the limitation of liability for (1) self-dealing, (2) bad faith, (3) intentional adverse acts, and (4) reckless indifference with respect to the beneficiary and his best interest." *Id*. at 343.

The Texas Supreme Court subsequently eliminated the idea of "public policy" limitations on exculpatory contractual limitations that had been expressed in *Grider* when it decided *Texas Commerce Bank, N.A. v. Grizzle*, 96 S.W.3d 240 (Tex. 2002). In *Texas Commerce Bank*, a trust case, the Court refused to uphold a non-statutory public policy limitation on the use of exculpatory provisions in interpreting the Texas Trust Code. *See id*. The Texas legislature responded to Texas Commerce Bank by amending Section 113.059, of the Trust Code, by enacting a short-lived statutory change precluding settlors from relieving a trustee from liability for a breach of trust committed in bad faith, intentionally, or with reckless indifference to the beneficiaries. The Trust Code was amended again, however, effective of January 1, 2006, to apparently provide settlers with ultimate authority to effectively grant immunity to trustees from liability for any improper action, including those committed in bad faith. TEX. PROP. CODE, Section 114.007, (c) Exculpation of Trustee.

Under BOC Section 153.152, the general partners of a limited partnership can argue for enforcement of broad exculpatory provisions that drastically limit their liability for breaching the

duties of loyalty, care, and good faith. Unless and until the courts or the legislature clarify the law in this area, general partners should attempt to negotiate broad limitations of liability provisions (with applicable severability and savings clauses).

IV. CONTRACTUAL INDEMNIFICATION OF GENERAL PARTNERS

The Texas Business Organization Code, like the Texas Revised Limited Partnership Act, contains provisions that set forth the circumstances under which a limited partnership must or may indemnify its partners and officers for liabilities, and reimburse them for expenses. *See* V.T.C.A., BOC Sections 8.051, 8.052, 8.101.

In summary, a limited partnership ***must*** indemnify and reimburse its officers and other governing persons for reasonable expenses incurred in connection with defending themselves from litigation or other charges that arose out of their role as a governing person of the limited partnership if such person succeeds on the merits in connection with such litigation or charge. BOC Section 8.051. A limited partnership ***may*** indemnify and reimburse its officers and other governing persons if they acted in good faith, reasonably believed their conduct was in the best interest of the partnership or that it was not opposed to the partnership's best interest (in cases of conduct outside the general partner's official capacity), and, in the case of criminal proceedings, had no reasonable cause to believe the conduct was unlawful. BOC Section 8.101. Finally, a limited partnership is ***prohibited*** from indemnifying a general partner or officer who is found liable to the limited partners or the partnership for an improper personal benefit if the liability arose out of willful or intentional misconduct, or a breach of the duties of loyalty or good faith. BOC Sections 8.102(a) and (b).

Rather than specifying all of the statutory guidelines regarding indemnification, limited partnership agreements often provide more simply that the partnership will indemnify its general

partner and officers to the fullest extent permitted by applicable law, as demonstrated by the following sample provision:

> The Partnership shall have the power and authority to and shall, and the General Partner is hereby directed on behalf of the Partnership to, indemnify and hold harmless, and advance and reimburse expenses related thereto to, the General Partner and the officers, directors, and employees of the General Partner to the fullest extent permitted by any applicable law.

This provision avoids disputes over the enforceability of a given indemnification provision and ensures maximum protection available by law for partners and officers.

V. REMOVAL OF GENERAL PARTNERS AND RELATED CONTRACTUAL PROTECTIONS

Apart from a bankruptcy, receivership, reorganization, death, or specific removal provisions in a partnership agreement, a general partner is not generally subject to removal as the general partner of a limited partnership. *See* BOC Section 153.155; *see also* Vernon's Ann. Civ. St. art. 6132a-1, § 4.02. Thus, removal is a subject of tremendous importance when drafting a limited partnership agreement.

General partners stand to gain from the omission of any reference to removal in the partnership agreement. By contrast, limited partners must negotiate specific removal rights to ensure adequate recourse for poor management or, more importantly, fraudulent conduct by the general partner(s).

To the extent that a general partner is unable to avoid addressing removal in the context of a limited partnership agreement, a clause that limits removal to instances of fraud or willful misconduct resulting in material harm to the partnership is preferred to an at-will removal clause. For instance, a clause that is favorable to the General Partner would provide as follows:

> The Limited Partner shall have the right, for cause, exercisable by written notice given to the General Partner to effect the removal of the General Partner. Cause shall mean fraud and/or willful misconduct by the executive officers or directors

> of the General Partner resulting in material harm to the Partnership. In the event the General Partner shall contest the validity of such removal, such removal shall not become effective unless and until a court of competent jurisdiction (including any court to which an appeal may be taken) shall have determined that cause (as hereinabove defined) for such removal has been established. If the General Partner is successful in its contest of any removal attempt by the Limited Partner, then all attorneys fees, costs and expenses incurred in connection with such contest shall be borne and paid by the Limited Partner.

At a minimum, this provision ensures that a general partner can avoid removal based on claims of poor management and, perhaps, even gross negligence. By requiring a court to establish the existence of sufficient cause for removal and levying the attorney fees and costs associated with an unsuccessful challenge on the limited partners, a general partner can make its removal from power extremely difficult and unlikely.

VI. THE USE OF CORPORATE GENERAL PARTNERS TO LIMIT LIABILITY AND RELATED ISSUES

The general partners of a limited partnership are liable for the limited partnership's debts and obligations. BOC Section153.152. Individuals can attempt to shield themselves from liability as general partners of a limited partnership by forming a corporation or a limited liability company (an "LLC") to serve as the general partner, while limiting their own respective roles in the partnership to that of limited partners.

The Texas Business Organization Code provides that a limited partner is not liable for the obligations of a limited partnership unless the limited partner "participates in the control of the business." BOC Section 153.102(a)(2). This statutory protection appears to be of little value for limited partners who want or need to participate in the management and day-to-day affairs of the business. There are specific statutory carve-outs, however, from the definition provided for "participation in the control of the business" that permit limited partners to act as shareholders, officers, or directors of a corporate general partner or as the members or managers of a general

partner that is an LLC without jeopardizing their liability protection as limited partners. BOC 153.103(1). Thus, the Texas Business Organization Code provides that serving as an officer or member of a corporate or LLC general partner does not constitute "participation in the control of the business" by a limited partner.

The scope of authority granted to limited partners by the statute does not afford them free reign to run a limited partnership's business as officers of a corporate general partner without exposure to partnership liabilities. Limited partners who simultaneously serve as officers or members of a corporate general partner or LLC must take steps to ensure that the corporate or LLC general partner is not disregarded in the context of a claim that the veil of the corporate general partner should be pierced.

Unfortunately, courts have provided little guidance to practitioners and the public regarding the minimum standards for corporate formality and practice that will avoid this type of liability exposure. In *Pinebrook Properties, Ltd. v. Brookhaven Lake Owners Ass'n*, a court of appeals held that an LLC was not the alter ego of one of its members despite the following facts: (i) the LLC had no checking account; (ii) the LLC had not filed any tax returns; (iii) the member sent letters on the partnership's behalf without designating any representative capacity in relation to the LLC; (iv) the member's contributions were the LLC's only source of income; and (v) the member publicly referred to the limited partnership's property as his property. *Pinebrook,* 77 S.W.3d 487, 500 (Tex. App. – Texarkana 2002, pet denied).

The court in *Pinebrook* held that corporate formalities are not a factor in determining alter ego. *Id*. Instead, the court focused upon whether there was a unity of interest between the member and the LLC such that the separateness had ceased to exist. *Id*. The court refused to find a unity of interest, because (i) there was no evidence that the member commingled personal

funds with LLC funds; (ii) there was no indication that the member used the LLC for personal purposes; and (iii) the LLC had other members apart from the alleged alter ego member. *Id*. at 500-501.

Apart from the factors discussed in *Pinebrook Properties*, courts have made it clear that the corporate general partner's capitalization is an important factor to be considered in veil-piercing claims. *See Humphreys v. Medical Towers, Ltd*., 893 F.Supp. 672 (S.D. Tex. 1995), aff'd without opinion, 100 F.3d 952 (5th Cir. 1996) (denying summary judgment of veil-piercing claim against corporate general partner's sole shareholder based upon evidence that the corporate general partner was undercapitalized and paid for some the defendant's personal expenses); *see also Autrey v. 22 Texas Services Inc*., 79 F.Supp.2d 735 (S.D. Tex. 2000) (denying summary judgment of veil-piercing claims involving corporate general partners under Pennsylvania law due to evidence of undercapitalization).

Thus, limited partners should be advised to provide sufficient capitalization to a corporate or LLC general partner, and to avoid commingling personal funds with the general partner or using the general partner for purposes that are inconsistent with its management and control of the limited partnership's business.

VII. MINORITY SHAREHOLDER OPPRESSION CLAIMS

The "minority shareholder oppression" scenario arises only in the context of a private business, including the close corporation. An investor in a large, publicly-held corporation can feel oppressed, *i.e.*, because his investment goals are thwarted by the management's operation of the company or that management engaged in "bad acts." The public company investor has a ready exit, however, because his shares may always be sold in the open market.[5] The owner of

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

stock in a closely held company lacks this option, because there is typically is no market for the shares of a close corporation. Moreover, in many close corporations, a shareholder's agreement includes restrictions on the minority shareholder's stock's sale or transfer. The non-marketable nature of an investment in a close corporation makes it possible for a controlling shareholder to "squeeze out" the minority owner from any role in the company's management or operations, while also "freezing out" the minority owner's ability to cash out on his or its investment.

As noted earlier, the downturn in the economy in the past few years has largely removed opportunities to resolve shareholder disputes in private companies through a buy-out. As a result, many investors in private, or closely-held businesses, have been frustrated by a structural and economic inability to monetize their investments. In the wake of this frustration and absence of express legal authority, these investors are turning to courts to seek relief from the oppression they contend that they have experienced at the hands of the controlling majority owners.

A. Texas Statutory Overlay

1. Texas Business Corporations Act

Texas statutes do not provide a remedy for minority shareholders in private companies who allege oppression <u>except</u> in extreme circumstances. Article 5.14(L), of the Texas Business Corporations Act ("TBCA"), authorizes a direct action by a shareholder against a corporation for the shareholder's own benefit in a closely held company. While the TBCA allows the minority shareholder to bring a claim directly against the company rather than through a procedure-laden derivative suit in closely held company, the statute does not provide a minority shareholder who claims oppression with the right to redeem his or its shares based on that claim. In short, the statute does not provide a simple mechanism for a frustrated minority shareholder to redeem his shares because of oppressive actions by the majority owners who control the company.

There is a statutory hammer, however, that judges have used to chip away at the business judgment rule and to craft a remedy for oppressed minority shareholders. Articles 7.05 and 7.06, of the TBCA, authorize courts to appoint a receiver or to liquidate the company as remedies for "illegal, oppressive, or fraudulent" conduct by "directors or those in control." (emphasis added) The landmark Texas case in this area, *Davis v. Sheerin*[6] (discussed later in depth), relies on the language of Articles 7.05 and 7.06 to uphold a claim for minority shareholder oppression. The appellate court in *Davis* upheld a jury verdict of oppressive conduct, based on: (i) findings of a conspiracy by the majority shareholders to deprive the plaintiff of his interest in the corporation, (ii) findings that the majority wasted corporate funds and received dividends that were withheld from the plaintiff, and (iii) undisputed evidence that the plaintiff would be denied any future voice in the corporation's management.

2. Texas Revised Limited Partnership Act

The Texas Revised Limited Partnership Act ("TRLPA") provides a remedy similar to the provisions that are included in the TBCA. Section 8.02, of the TRLPA, allows for the judicial dissolution of a limited partnership when:

(1) the economic purpose of the limited partnership is likely to be unreasonably frustrated;

(2) another partner has engaged in conduct relating to the limited partnership business that makes it not reasonably practicable to carry on the business in limited partnership with that partner; or

(3) it is not reasonably practicable to carry on the business of the limited partnership in conformity with the partnership agreement.

[6] 754 S.W.2d 375, 382-83 (Tex.App.–Houston [1st Dist.] 1988, writ denied). The *Davis* court crafted a court-ordered buy-out of the plaintiff's stock at fair value, as an acceptable "less harsh" remedy to the statutorily authorized liquidation, available to the court under its "general equity powers" when "oppressive conduct" had occurred. *Id*. at 378, 380, 382-83.

The theory behind this provision – that a court can dissolve a partnership when relations between the partners renders it impractical for the partnership to conduct business – was applied by an Illinois Appellate Court to compel dissolution of a partnership.[7] In *Susman v. Venture*, the general partners had a dispute with Susman, a limited partner, over the sale of the partnership assets. The general partners later removed Susman's name from the tax records and refused to provide him with any information. These acts were considered sufficient to justify judicial dissolution as a remedy for the aggrieved minority.

3. Texas Limited Liability Company Act

It appears that minority oppression claims under the Texas Limited Liability Company Act ("LLC Act") would be handled similarly to claims brought under the TBCA and the TRLPA. Article 2.02, of the LLC Act, grants each limited liability company ("LLC") "the power provided for a corporation under the TBCA and a limited partnership under the Texas Revised Limited Partnership Act." An LLC, then, would likely enjoy the statutory benefits typically awarded to both corporations and partnerships.

The negative implication of these powers is that a court would likely view an oppressed minority member of an LLC in the same light as an oppressed shareholder or limited partner. In other words, relief would be available to a member under the LLC Act only in the extreme circumstances required by the TBCA and TRLPA. In fact, the language of Article 6.02, of the LLC Act, authorizes that "a court of competent jurisdiction may decree dissolution of a limited liability company if it is not reasonably practicable to carry on the business of the limited liability company in conformity with its articles of organization and regulations."

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[7] *Susman v. Venture,* 114 Ill.App. 3d 668, 70 Ill. Dec. 268, 449 N.E.2d 143 (1982).

This provision of the LLC Act has yet to be tested in Texas, but it seems safe to predict that, upon proof of sufficient, valid evidence, the court would order liquidation, or alternatively "less-harsh"[8] remedies, to protect an LLC member with a minority ownership interest who was being oppressed by the members holding a majority interest in the organization.

B. Additional Factors Addressed By The Courts

1. A Departure from the Business Judgment Rule

It is not surprising that Texas courts have fashioned remedies for minority shareholders claiming oppressing in light of the general nature of Texas statutes that empower shareholders in dire situations to dissolve private companies. The "less-harsh" non-dissolution remedies set forth in *Davis v. Sheerin* are judicial in nature, and are not provided by statute. Nevertheless, these remedies provide the basis for the state's evolving doctrine of minority shareholder oppression.

Before *Davis v. Sheerin*, Texas courts had been reluctant to issue rulings that impacted the relationships among shareholders or partners and the entities in which they invested. In the pre-*Davis v. Sheerin* era, courts accorded great deference to officers and directors under the "business judgment rule."[9] The long-standing existence of the business judgment rule led courts to adopt a hands-off approach under the common law rule that officers and directors "shall not be held liable for an honest mistake of judgment if he acted with due care, in good faith, and in furtherance of a rational business purpose."[10]

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[8] *Davis*, 754 S.W.2d at 380.

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

[10] *FDIC v. Wheat*, 970 F.2d 124, 130-131 (5th Cir. 1992).

Davis v. Sheerin certainly did not overturn the business judgment rule, but the minority shareholder oppression doctrine contains elements that do conflict to some extent with the rule. In considering claims by minority shareholders, Texas courts have begun to scrutinize with less deference the actions of majority owners to determine whether they engaged in "burdensome, harsh, and wrongful conduct"[11] and to assess whether the majority owners' actions thwarted the "reasonable expectations"[12] of the minority shareholders. The Fifth Circuit Court of Appeals, in *Hollis v. Hill*[13], closely examined the application of the business judgment rule in a case where a controlling shareholder was clearly oppressing a frozen-out minority. The court stated that:

> "[i]n the context of a closely held corporation, many classic business judgment decisions can also have a substantial and adverse affect on the 'minority's' interest as shareholder. Close corporations present unique opportunities for abuse because the expectations of shareholders in closely held corporations are usually different from those of shareholders in public corporations."[14]

The *Hollis* court affirmed the lower court's decision requiring a buy-out of the minority's shares based on a finding of breach of fiduciary duty and oppressive conduct by the majority.

2. Fiduciary Duties Imposed on Majority Owners for Benefit of the Minority Owners

The longstanding general rule in Texas is that corporate fiduciary duties are owed solely by the corporation's officers and directors to the entity, not to its shareholders.[15] A corporate director's fiduciary duties have been deemed to run solely to the corporation, and shareholders

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[11] *See supra* note 2.

[12] *See supra* note 1.

[13] 232 F.3d 460 (5th Cir. 2000).

[14] *Id.* at 467.

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

were therefore without standing to enforce those duties, except through a derivative lawsuit that was filed on behalf of the corporation.[16]

The doctrine of minority shareholder oppression in Texas, however, makes an exception to this precedent, because breaches of fiduciary duties that the majority owners owe directly to the minority shareholders are considered grounds for a judicial finding of oppression. In *Duncan v. Lichtenberger*[17], the appellate court awarded damages to two minority shareholders who never received compensation as officers or dividends as shareholders. The court noted that "[t]he breach of a fiduciary duty is the type of wrong for which the courts of this State will afford a remedy."[18]

Almost 50 years ago, the Texas Supreme Court held that majority shareholder's failure to declare dividends constituted fraud and an abuse of his control.[19] In *Patton v. Nicholas*, the Court affirmed the jury's verdict, observing that "the malicious suppression of dividends is a wrong akin to a breach of trust, for which the courts will afford a remedy." The *Patton* court issued an injunction requiring the corporation to pay a reasonable dividend "at the earliest practical date," as well as in future years.[20]

In the partnership context, oppression based upon a breach of fiduciary duties has also been upheld.[21] The Court of Appeals in Tyler ultimately held in *Cleaver v. Cleaver* that the

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[16] *Faour v. Faour*, 789 S.W.2d 62 (Tex. App.–Texarkana 1990, writ denied).

[17] 671 S.W.2d 948 (Tex.App.–Fort Worth 1984, writ ref'd n.r.e.).

[18] *Id*. at 950.

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

[20] *Id*. at 849.

[21] *Cleaver v. Cleaver*, 935 S.W.2d 491 (Tex.App.–Tyler 1996, no writ).

plaintiff was not a partner (and therefore lacked standing to assert a claim for breach of fiduciary duties). The court noted, however, that fiduciary duties would have to be weighed for a court to properly assess the policy of the managing partner that was subject to challenge, *i.e.*, retaining earnings rather than declaring distributions

VIII. DEFINING THE CAUSE OF ACTION FOR MINORITY SHAREHOLDER OPPRESSION

A. Wrongs Commonly Suffered By The Minority Owner

This article reviews two avenues for relief by minority owners who claim their ownership interests are being oppressed by majority owners. Texas case law supports claims by minority owners for breach of fiduciary duty against majority owners. There is also a line of cases that is primarily outside Texas, which fleshes out a statutory right to judicially ordered dissolution as an extreme remedy for oppression.[22] Cases arising in other jurisdictions, including West Virginia, North Dakota and New Jersey, also support claims for judicially- ordered dissolution under statutes in those states, which expands the range of remedies available for shareholder oppression to include receivership, forced buyout, dividend, reduction of excessive management salaries and injunction against further oppressive acts.[23]

It is typical to find one or more of the following freeze-out techniques in cases where minority shareholder oppression has been alleged:

- Termination of the minority interest owner's employment with the company;

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[22] *See Davis v. Sheerin*, *supra*, 754 S.W.2d at 382-83.

[23] *See Masinter v. Webco Co.*, 262 S.E.2d 433 (W.Va. 1980) (listing ten possible forms of relief for oppressive conduct); *Balvik v. Sylvester*, 411 N.W.2d 383 (N.D. 1987) (listing alternatives to dissolution such as receivership, buyout, and forced dividends); and *Brenner v. Berkowitz*, 634 A.2d 1019 (N.J. 1993) (noting that courts have a wide variety of equitable remedies available to address shareholder oppression situations). *But cf. Giannotti v. Hamway*, 387 S.E.2d 725 (Va. 1990) (which calls dissolution the exclusive remedy for oppression).

- Retention of dividends/earnings by the company, *i.e.,* payment of salaries and benefits to the majority owners rather than dividends shared by minority owners;
- Removal of the minority shareholder from management and from the opportunity to participate in corporate decision-making; and
- Denial of access by the minority shareholder to financial and business information regarding the company's activities and operations.

Not every example of the conduct listed above rises to the level of minority shareholder oppression. For example, terminating the employment of a minority shareholder who is also an employee at-will does not automatically translate into a valid oppression claim. The threshold question of whether minority shareholder oppression has taken place is generally decided by the court after the jury determines that some oppressive conduct, took place. The *Davis* court held that "[a]lthough whether certain acts were performed is a question of fact, the determination of whether these acts constitute oppressive conduct is usually a question of law for the court."[24]

B. Parameters Of Oppressive Conduct By Majority Owners Toward Minority Shareholders Under Texas Law

1. *Davis v. Sheerin* Validates the Claim

Davis v. Sheerin, decided in 1988, is considered a landmark, modern-day decision that established a minority shareholder's claim for oppression. The TBCA fails to define oppressive conduct[25] by majority shareholders, and *Davis v. Sheerin* and its progeny are the best source for defining the term although, again, it has not been recognized as a separate cause of action by the Texas Supreme Court. The *Davis* court did indicate, however, that oppressive conduct was an independent ground for relief – not necessitating any showing of fraud, illegality, deadlock, mismanagement, or wasting of assets. The *Davis* court therefore attempted to interpret the term "oppressive conduct" and to define the cause of action for minority oppression.

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[24] *Davis v. Sheerin*, *supra*, 754 S.W.2d at 380.

[25] Texas Business Corporations Act, Articles 7.05 and 7.06.

In *Davis*, a 45% minority shareholder brought suit individually and for the corporation against William Davis and Catherine Davis, alleging oppressive conduct and breach of fiduciary duty.[26] All parties were corporate officers and directors, and the plaintiff served as president and an employee running its daily operations. Over time, the relationship between the Davises and Sheerin deteriorated, to the point that Sheerin was denied access to corporate books and records and was told he no longer had any ownership interest in the corporation.

The *Davis* court observed that "[o]ppressive conduct has been described as an expansive term that is used to cover a multitude of situations dealing with improper conduct, and, therefore, a narrow definition would be inappropriate."[27] Consequently, the court continued, "[c]ourts may determine, according to the facts of the particular case, whether the acts complained of serve to frustrate the legitimate expectations of minority shareholders, or whether the acts are of such severity as to warrant the requested relief."[28] The majority's actions in *Davis* – a willful conspiracy to deprive the plaintiff of his interest in the corporation, receipt of informal dividends through profit sharing contributions denied to the plaintiff, and wasting of corporate funds by paying for legal fees – were deemed to be oppressive because "[a]ppellant's conduct not only would substantially defeat any reasonable expectations appellee may have had . . . but would totally extinguish any such expectations."[29]

[26] *Davis v. Sheerin, supra*, 754 S.W.2d at 377.

[27] *Id.* At 381 (citing *McCauley v. Tom McCauley & Son, Inc.,* 104 N.M. 523, 724 P.2d 232 (Ct. App. 1986).

[28] *Id.*

[29] *Id.* at 382 (citing *In re Wiedy's Furniture Clearance Center Co.* 108 A.D.2d 81, 487 NY.S.2d 901 (1985).

2. *Willis v. Bydalek* Establishes a Balance

Not every "bad act" by majority owners is considered oppressive. The Court of Appeals in Houston (1st Dist.) considered a shareholder oppression claim in *Willis v. Bydalek*[30] a decade after *Davis*, and limited the oppression claim. In *Willis*, the corporation operated a nightclub that never earned a profit and never paid any dividends. Eventually, the plaintiff was removed from management by the majority, but the *Willis* court did not find sufficient evidence to support the oppression claim, despite the minority shareholder having been locked out of the corporation's nightclub and deprived of employment. The jury found a wrongful lock-out, but did not find that the majority had misused corporate funds or had suppressed dividends (the company was never profitable and no dividends were ever distributed to <u>any</u> shareholders).[31] The court declined to view these acts as oppressive, and determined that the firing of the minority investor/employee was not oppressive, because he was an at-will employee.[32] The *Willis* decision stressed that "[c]ourts must exercise caution in determining what shows oppressive conduct."[33]

C. Judicially-Fashioned Remedies For Minority Shareholder Oppression

1. Buyout For Fair Value of Minority Interest

Texas courts have fashioned a varied range of solutions in efforts to provide a remedy for legitimately aggrieved minority shareholders after they have established oppression committed by the majority owners. In *Davis v. Sheerin*, the court determined that an award of damages or

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

[31] *Id.* at 802.

[32] *Id.*

[33] *Id.* at 801 (citing *McCauley*, 724 P.2d at 237).

injunctive remedies were not adequate to fully protect the minority owner's interests and rights.[34] The court opined that "[a]n ordered 'buy-out' of stock at 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."[35] The court concluded 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." [36]

2. Reimbursement of Investment

The Fort Worth appellate court in *Duncan v. Lichtenberger* ordered that the minority shareholder plaintiffs be reimbursed all funds they had paid to the corporation to buy their stock.[37] The *Duncan* court noted that "[t]he remedy chosen by the appellees in the present case was the restoration of the monies conveyed to Duncan for their shares of stock . . . ."[38] This reimbursement of funds is not provided by Texas statutes and seems to be a judicially accepted alternative to dissolution when oppressive conduct has been found.

3. Injunctive Relief

In a Texas Supreme Court case predating *Davis v. Sheerin* by several decades, *Patton v. Nicholas*[39], the Court provided indications of the types of relief that trial courts are authorized to

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[34] *Davis v. Sheerin*, *supra*, 754 S.W.2d at 383.

[35] *Id.* at 380.

[36] *Id.*

[37] *Duncan v. Lichtenberger*, *supra*, 671 S.W.2d at 953.

[38] *Id.*

[39] *Supra*, 279 S.W.2d 848.

grant when receivership or liquidation is too extreme a remedy. In *Patton*, the trial court held that the majority owner in a close corporation had wrongfully dominated the board and prevented declaration of dividends. The trial court issued a mandatory injunction requiring the corporation to pay a reasonable dividend immediately and to continue paying substantial dividends in future years.[40] Dividends have been ordered in other jurisdictions as well as forms of injunctive remedy intended to redress majority oppression.[41]

IX. PRACTICAL SUGGESTIONS TO AVOID SHAREHOLDER OPPRESSION CLAIMS

A. Measures To Consider In Forming Business Entity

When forming a close corporation, limited partnership or LLC in Texas, it is helpful to begin with the final objective in mind. Thoughtful planning during the formation stages can protect the entity from eventual oppression claims. Practical start-up suggestions for avoiding a minority shareholder oppression lawsuit include the drafting and inclusion of:

1. Redemption Agreement

Create a redemption right in the Shareholder Agreement (or in the Partnership Agreement). A comprehensive redemption agreement will provide shareholders the opportunity to have their stock repurchased by the corporation under a specific formula to determine the "fair value" of the stock at the time of redemption by independent experts or mutual appraisals. One effective, but more controversial, form of redemption clause is the "Shotgun Buy-Sell." A minority shareholder triggers this mechanism by making an offer to other shareholders to sell all his shares at a specific price per share, or to buy all of the majority's shares at the same price. This forces a consolidation of the shares into the hands of either the

[40] *Id.* at 857.

[41] See, e.g.*http://www.westlaw.com/Find/Default.wl?rs=++++1.0&vr=2.0&DB=4645&FindType=Y&ReferencePositionType=S&SerialNum=2001966836&Referen* *Naito v. Naito*, 35 P.3d 1068, 1080 (Or. Ct. App. 2001) (in which the court ordered dividends to be paid from a corporation with over $5 million in retained earnings after noting that "the corporation did not contemplate any new ventures that would call for extraordinary resources").

majority or minority, and provides an effective way to terminate the shareholder relationship if disputes arise.

2. Right Of First Refusal

A clause allowing a right of first refusal will give the majority the right to purchase a minority's shares if the minority shareholder receives a bona fide offer from a third party to purchase all or part of his shares. Generally, this right contemplates that the majority can purchase the shares under the same terms and conditions that are contained in the third-party offer.

3. Survivorship Provisions

Including a survivorship provision in the Shareholder's Agreement can give the corporation the option to purchase any deceased minority shareholder's shares, rather than having those shares pass automatically to the deceased's heirs – heirs who may not have any knowledge or experience in the business and who might allege oppression claims if they are denied full access to the operations and management of the corporation, even if that denial appears justified to the majority.

• 4. Defined Dividend Policy

If the company will not be declaring dividends, management should explain up-front the anticipated use of net revenues (if any) so as to avoid allegations that the majority is withholding distribution of profits and thereby oppressing minority shareholders.

• 5. Employment Agreements

Compensation is often a way to distribute the profits of a close corporation, and a majority shareholder's decision to end the employment of a minority shareholder may therefore be considered oppressive.[42] As a result, it may be advisable for the majority shareholders/managers to consider entering into employment contracts with top corporate executives for a specific term. With employment agreements in place, the contract may not be renewed at the end of the term, which lessens the thrust of a minority shareholder's claim for alleged freeze out based on a sudden termination of his employment.

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[42] *But cf. Willis v. Bydalek*, *supra,* 997 S.W.2d at 802 (finding that the circumstances of the majority terminating the minority's at-will employment in this case did not constitute oppression).

B. Post-Formation Actions By Management

Even if minority shareholder oppression claims are not taken into consideration during the formation stages of a business entity, the majority still can take precautions in governing the entity to avoid the type of conduct that would support an oppression claim. Prudent practices by controlling majority shareholders include the following actions:

- **1. Adhere To By-Laws**

  Follow the relevant statutes and operative by-laws of the entity.

- **2. Conduct Regular Board/Managers Meetings**

  Hold regular meetings, to serve as a forum to explain management decisions to the minority and to share the reasoning behind majority actions.

- **3. Provide Periodic Financial Reporting**

  Issue periodic financial reports, in order to put the minority shareholders on notice of the financial situation of the corporate entity.

4. Allow Voting Rights

Provide all shareholders with the opportunity to vote.

5. Establish Dividend Policy

Articulate and institute a dividend policy, if one was not included in the Shareholder’s Agreement. (If the organization is an LLC, it would be wise to strongly consider issuing at least a dividend that will cover the member’s tax liability, even if no other dividends are to be issued.)

- **6. Avoid Appearances Of Fiduciary Breaches**

  Be sensitive in avoiding conduct that could be interpreted as self-dealing or as self-interested transactions. Policies of full disclosure, securing board approval for majority corporate actions, and ratification can all help avoid later allegations of improper acts by the majority.

- **7. Remove Transfer Restrictions On Stock**

  Consider removing transfer restrictions on a minority's ability to sell his interest. Clearly, the pros and cons of this decision would have to be weighed carefully; however, it is unlikely that a court will find oppression where market-access is present.

X. READING THE TEA LEAVES: WHERE DOES THE SHAREHOLDER OPPRESSION DOCTRINE GO FROM HERE

A. The Impact Of Sarbanes-Oxley On Those Holding Ownership Interests In Private Texas Companies

Some lawyers who litigate shareholder oppression claims have privately expressed concern that a conservative Texas Supreme Court may overturn or at sharply curtail the scope of relief afforded to minority shareholders under *Davis v. Sheerin*. Yet, there are other currents at work that may cause the Supreme Court to give credence to the minority shareholder oppression doctrine. Chief among these trends is the strong public perception that the corporate leaders of public companies have frequently run amok in recent years. The distress over the recent flagrant misconduct of officers in public companies, and the devastating result to their companies and shareholders, led to the passage of the federal Sarbanes-Oxley Act in 2003.

It is difficult to predict what effect, if any, governmental regulation of public companies will have on: (i) the duties owed by majority owners of private companies under common law and (ii) the common law rights of minority shareholders. The increased public sensitivity to offensive, self-dealing conduct by corporate leaders in the public arena, however, seems to be

consistent with cases that uphold rights and remedies of minority shareholders when they are able to establish that they have been subject to economic oppression by majority owners.

B. Support For *Davis V. Sheerin* And Minority Rights

1. *Hollis v. Hill*: The Fifth Circuit Weighs In

The Fifth Circuit took the opportunity of the *Hollis v. Hill* case[43] to synthesize a "general" law of shareholder oppression among several jurisdictions. Although this case was decided in 2000, before Sarbanes-Oxley, the case remains valid law in the Fifth Circuit.

In *Hollis*, the alleged oppressive conduct took place in Texas, but it involved a Nevada corporation. Nevada does not have a minority shareholder oppression statute, and there are no Nevada Supreme Court decisions that lend guidance, which caused the Fifth Circuit to consider Texas law, as well as case precedent in other jurisdictions.

Hollis and Hill were each 50% shareholders, officers and employees in a corporation that marketed first-lien mortgage notes and other non-security financial products. Their wives were also both employed in the company. Hill had the more active management role, and was treated by the trial court as well as the Fifth Circuit as the "majority" shareholder. The Fifth Circuit affirmed the lower court finding of breach of fiduciary duty, based on a series of "oppressive" acts committed by Hill, "including the diminution and eventual termination of salary, the failure to deliver financial information, the closing of one of the company's offices, termination of employment, and the cessation of benefits . . . ."[44] The appellate court recognized these were all "classic examples of acts typically shielded from judicial scrutiny under the business judgment

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[43] 232 F.3d 460 (5th Cir. 2000).

[44] *Id.* at 467.

rule"[45] – yet still affirmed that the acts, taken together, constituted a breach of fiduciary duties when perpetrated by the controlling shareholder within the context of a closely held corporation.

The Fifth Circuit affirmed the trial court's decision in all but one major respect. The court-ordered buyout was upheld to remedy Hill's breach of fiduciary duties toward Hollis, but the Court declined to adopt the trial court's valuation date. Noting that "many of the actions upon which we base our finding of oppression occurred after this date,"[46] the Court declared that "the date of valuation for the court ordered buy-out should be the date suit was filed herein."[47] The case was remanded for the trial court to determine the proper valuation of Hollis' shares.

2. Willis v. Donnelly: Majority's Oppressive Conduct and Domination of the Business Constitutes Breach of Fiduciary Duty to Minority

In *Willis v. Donnelly,*[48] the principal/majority shareholder trampled on the rights of the minority shareholder. In a complex case presenting numerous procedural issues, the court cited a lengthy list of oppressive activities by the majority owner harmful to the minority shareholder.

Willis, a Houston businessman, was the majority owner of Urban Retreat, an upscale day spa and salon. Donnelly, a popular hairstylist, was brought in to supply a salon clientele and to manage the spa. The court found that Willis "engaged in oppressive conduct and dominated control over the business."[49] Willis had induced Donnelly to join the business with unfulfilled promises to provide capital, he kept the business under-capitalized, allowed it to fall deeply into debt, and thereby rendered Donnelly's shares worthless.

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[45] *Id.*

[46] *Id.* at 472.

[47] *Id.*

[48] 118 S.W.3d 10 (Tex.App.–Houston [14th Dist.] 2003).

[49] *Id.* at 32.

Willis also engaged in self-dealing transactions involving the spa's realty, diluting the value of the shares and utilizing the business assets for his sole benefit. In addition, Willis improperly transferred all the stock to his wife, ignoring Donnelly's right of first refusal. He reduced Donnelly's salary, delayed issuing his stock, and treated him like a non-owner. The court looked at the amassed evidence and declared that Willis "would owe a fiduciary duty to Donnelly in repurchasing his shares."[50]

C. Potential Limits Imposed On The Minority Shareholder Oppression Doctrine

Not all cases in which oppression is alleged result in findings favorable to the minority owner. In the two cases noted below, the majority owners prevailed, and it remains to be seen whether this trend will increase, and thereby place limits on claims for minority shareholder oppression and diminish the importance of *Davis v. Sheerin*.

1. *Pinnacle Data Services, Inc. v. Gillen*: Allegations Must be Supported with Evidence

In *Pinnacle Data Services, Inc. v. Gillen*[51], the Texarkana Court of Appeals considered the case after the plaintiff's claims had been dismissed by the trial court on summary judgment, a combination of no evidence and traditional motion requesting summary dismissal. The minority members in a Texas LLC alleged that the majority had "committed member oppression by wrongfully withholding profit distributions, firing Max and Morris Horton from MJCM, failing to inform PDS of company actions, and paying for their personal legal fees in this lawsuit with MJCM funds."[52] The appellate court upheld the grant of the majority's no-evidence motion for

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[50] *Id.* at 33.

[51] 104 S.W.3d 188 (Tex.App.–Texarkana 2003).

[52] *Id.* at 196.

summary judgment on the issue of member oppression when the minority failed to produce any evidence in support of its oppression claim.

Mere recitations of oppressive conduct are not enough to support a claim – evidence of the oppression must be established. The types of oppressive conduct that were alleged by the Pinnacle Data Services minority owners, if they had been proven, were precisely the types that warranted findings of oppression in other cases in which the minority was granted relief.

2. *Rudisill v. Arnold White & Durkee, P.C.*: Dissenters' Rights Denied

In a related case decided within the past two years, the Houston Court of Appeals declined to recognize the rights of minority owners/dissenters who alleged that the majority owners had acted in an oppressive manner. *See Rudisill v. Arnold White & Durkee, P.C.*.[53]

In *Rudisill*, three shareholders in a Houston law firm, Arnold White & Durkee ("AWD") sought a declaration of their rights after their firm merged with another law firm, Howrey & Simon ("H&S"). The trial court granted summary judgment against the minority shareholders, who appealed. The appellants had voted against the proposed combination of the two law firms and declined to sign agreements making them partners in the new law firm. The case centered on the minority shareholder/dissenters' claim that they were entitled to a "fair value" redemption of their ownership interest under the TBCA.

The dissenters based their claim for redemption on their contention that AWD had been completely "subsumed"[54] into the new law firm and that the remaining shell corporation did not conduct any business. The court found that the TBCA does not require any assets to be retained for a company to remain "in business" – the court noted that "the drafters of the TBCA

[53] *See Rudisill v. Arnold White & Durkee, P.C.* 148 S.W.3d 556 (Tex.App.-Hous. [14 Dist.] Sep 30, 2004) (NO. 14-03-00508-CV), rule 53.7(f) motion granted (Nov 17, 2004).

[54] *Id*. at 562.

envisioned that a corporation could continue in business despite transferring all of its assets and receiving only cash or corporate stock in return."[55] The firm was deemed to have remained "in business" even after the combination, and the merger did not require any special authorization under art. 5.11(A)(2) of the TBCA. As a result, the three appellants were not entitled to exercise, or benefit from, dissenter's rights of redemption.

The dissenters also contended, in the alternative, that they should be restored to their positions as shareholders and awarded their shares of any profits distributed since they resigned from AWD. The former minority-shareholders argued that article 5.13(A) of the TBCA would authorize them to return to shareholder status if their dissenter's rights claim was denied. The appellate court rejected this claim as well, holding that the TBCA provision would not apply because the shareholder status of the three appellants had been terminated before the dissenters' claim was made. The court placed great emphasis on the language of the AWD Redemption Agreement, which provided that the appellants' shares were considered redeemed the day that the shareholders' employment ended. The redeemed shares were deemed not to be "susceptible of revival and former shareholders [were] not entitled to reinstatement under the TBCA."[56]

Rudisill demonstrates, among other things, that any judicial trend toward protecting the interests of minority shareholders may not cause a court to interfere with established procedures for corporate governance in regard to minority shareholders. The AWD Redemption Agreement, to which the shareholders had agreed, provided them with an adequate redemption and protected the company from an over-reaching attack by minority shareholders. The TBCA provisions that authorize minority shareholders to obtain relief may not apply when the majority shareholders

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[55] *Id.*

[56] *Id.* at 564.

enter into the business relationship with the documentation necessary to protect all concerned parties – minority and majority.

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