SHAREHOLDER OPPRESSION IN TEXAS CLOSE CORPORATIONS: MAJORITY RULE (STILL) ISN'T WHAT IT USED TO BE

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I. INTRODUCTION

The doctrine of shareholder oppression protects the close corporation minority stockholder from the improper exercise of majority control. Although the Texas Supreme Court has not explicitly recognized the doctrine, appellate courts in Texas and in other jurisdictions have recognized and applied it in numerous decisions. Moreover, there is a statutory basis for the doctrine in Texas, as shareholders are given the right to petition for receivership, liquidation, or less harsh remedies on the grounds of oppressive conduct by "directors or those in control."[1] Because the shareholder oppression doctrine potentially alters a number of fundamental legal principles, it is critically important to be familiar with the doctrine's operation in close corporation disputes.

II. THE NATURE OF THE CLOSE CORPORATION

A close corporation is a business organization typified by a small number of stockholders, the absence of a market for the corporation's stock, and substantial shareholder participation in the management of the corporation.[2] In the traditional public corporation, a shareholder is normally a "passive" investor who neither contributes labor to the corporation nor takes part in management responsibilities. A shareholder in a public corporation simply invests money and hopes to receive a return on that money through capital appreciation and/or dividend payments.[3] By contrast, in a close corporation, a shareholder typically expects an active participatory role in the company, usually through employment and a meaningful role in

1. TEX. BUS. CORP. ACT arts. 7.05(A)(1)(c), 7.06 (2003); *see* TEX. BUS. ORGS. CODE §§ 11.404(a)(1)(C), 11.405 (2008) (addressing oppressive conduct by "the governing persons of the entity"); *see also* Davis v. Sheerin, 754 S.W.2d 375, 380 (Tex. App.—Houston [1st Dist.] 1988, writ denied) ("[W]e hold that a court could order less harsh remedies [than liquidation] under . . . equity powers.").

The Texas Business Organizations Code applies to all corporations on January 1, 2010. This article will cite to the existing Business Corporation Act and will give corresponding citations to the Business Organizations Code.

2. *See, e.g.*, Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 511 (Mass. 1975); *see also* TEX. BUS. CORP. ACT arts. 12.01-12.54 (2003) (setting forth the requirements for electing statutory close corporation status in Texas).

3. *See, e.g.*, Exadaktilos v. Cinnaminson Realty Co., 400 A.2d 554, 560 (N.J. Super. Ct. Law Div. 1979) ("Large corporations are usually formed as a means of attracting capital through the sale of stock to investors, with no expectation of participation in corporate management or employment. Profit is expected through the payment of dividends or sale of stock at an appreciated value.").

management.[4] A shareholder in a close corporation also invests money in the venture and, like all shareholders, he hopes to receive a return on that money. Because there is no active market for the company's shares,[5] however, any financial return is normally provided by employment compensation and dividends, rather than by sales of stock at an appreciated value.[6]

Conventional corporate law norms of majority rule and centralized control can lead to serious problems for the close corporation minority shareholder. Traditionally, most corporate power is centralized in the hands of a board of directors.[7] The directors set policy, elect officers, and supervise the normal operation of the corporation. Because directors are elected by shareholder vote, the board of a close corporation is typically controlled by the shareholder (or shareholders) holding a majority of the voting power.[8] Through this control of the board, a majority shareholder (or majority group) has the ability to take unjustified actions that are harmful to a minority shareholder's interests.[9] Such actions are usually designed to restrict (or deny

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4. *See, e.g., id.* at 561 ("Unlike their counterparts in large corporations, [minority shareholders in close corporations] may expect to participate in management or to influence operations, directly or indirectly, formally or informally. Furthermore, there generally is an expectation on the part of some participants that their interest is to be recognized in the form of a salary derived from employment with the corporation." (citation omitted)).

5. *See infra* notes 18-19 and accompanying text.

6. *See, e.g.*, Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657, 662 (Mass. 1976) ("The minority stockholder typically depends on his salary as the principal return on his investment . . . ."); Bonavita v. Corbo, 692 A.2d 119, 124, 126 (N.J. Super. Ct. Ch. Div. 1996); Ingle v. Glamore Motor Sales, Inc., 535 N.E.2d 1311, 1319 (N.Y. 1989) (Hancock, J., dissenting); Baker v. Commercial Body Builders, Inc., 507 P.2d 387, 397 (Or. 1973) ("It is also true that the Bakers, as stockholders, had a legitimate interest in the participation in profits earned by the corporation.").

7. *See* TEX. BUS. CORP. ACT art. 2.31 (2003) ("[T]he powers of a corporation shall be exercised by or under the authority of, and the business and affairs of a corporation shall be managed under the direction of, the board of directors of the corporation."); TEX. BUS. ORGS. CODE § 21.401 (2008).

8. *See, e.g.*, 1 F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL & THOMPSON'S OPPRESSION OF MINORITY SHAREHOLDERS & LLC MEMBERS § 1:2, at 1-3 (Rev. 2d ed. 2005) [hereinafter OPPRESSION] ("Indeed, in most closely held corporations, majority shareholders elect themselves and their relatives to all or most of the positions on the board.").

9. *See, e.g.*, Bostock v. High Tech Elevator Ind., 616 A.2d 1314, 1320 (N.J. Super. Ct. App. Div. 1992) ("[B]ased upon its voting power, the majority is able to dictate to the minority the manner in which the [closely held] corporation is run." (internal quotation omitted)); Meiselman v. Meiselman, 307 S.E.2d 551, 558 (N.C. 1983) ("[W]hen the personal relations among the participants break down, the majority shareholder, because of his greater voting power, is in a position to terminate the minority shareholder's employment and to exclude him from participation in management decisions."); Kiriakides v. Atlas Food Sys. & Servs., Inc., 541 S.E.2d 257, 267 (S.C. 2001) ("This unequal balance of power often leads to a "squeeze out" or "freeze out" of the minority by the majority shareholders." (footnote omitted)); *see also* Fix v. Fix Material Co., 538

all together) the minority's financial and participatory rights, and they are often referred to as "freeze-out" or "squeeze-out" techniques that "oppress" a minority shareholder in a close corporation.[10] Although "any one of a variety of activities or conduct can give rise to shareholder oppression,"[11] common oppressive actions include the termination of a minority shareholder's employment, the removal of a minority shareholder from the board of directors or other management position, the refusal to declare dividends, the denial of access to information, and the siphoning off of corporate earnings to the majority shareholder.[12]

S.W.2d 351, 358 (Mo. Ct. App. 1976) ("In the instant case [a group of four shareholders], acting in concert, control a majority of the outstanding stock, though no single shareholder owns 51%. Because this control carries the power to destroy or impair the interests of minority owners, the law imposes equitable limitations on the rights of dominant shareholders to act in their own self-interest."); *infra* notes 10-12 and accompanying text (discussing freeze-out tactics).

Keep in mind that the Texas oppression statute provides a remedy against "directors or those in control." Thus, although most shareholder oppression disputes involve abusive conduct by a majority shareholder (or majority group), the statute would seem to cover abusive conduct by a director or officer who is not a controlling shareholder. *See supra* note 1 and accompanying text.

10. *See* 1 OPPRESSION, *supra* note 8, § 1:1, at 1-2 n.2 ("The term 'freeze-out' is often used as a synonym for 'squeeze-out.'"). It has been noted that the term "squeeze-out" means "the use by some of the owners or participants in a business enterprise of strategic position, inside information, or powers of control, or the utilization of some legal device or technique, to eliminate from the enterprise one or more of its owners or participants." *Id.* at 1-2; *see also* Davis v. Sheerin, 754 S.W.2d 375, 381 (Tex. App.—Houston [1st Dist.] 1988, writ denied) (noting that, in a close corporation, "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").

11. Redmon v. Griffith, 202 S.W.3d 225, 234 n.3 (Tex. App.—Tyler 2006, pet. denied); *see id.* at 234 ("[A] claim of oppressive conduct can be independently supported by evidence of a variety of conduct.").

12. *See, e.g.*, Orchard v. Covelli, 590 F. Supp. 1548, 1557 (W.D. Pa. 1984) ("Tactics employed against a minority shareholder to effect a squeeze out can take on many forms including generally oppressive conduct, the withholding of dividends, restricting or precluding employment in the corporation, paying excessive salaries to majority stockholders, withholding information relating to the operation of the corporation, appropriation of corporate assets, denying dissenting shareholders appraisal rights, failure to hold meetings and excluding the minority from a meaningful role in the corporate decision-making."); Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 513 (Mass. 1975) (noting some of the common oppressive actions). *See generally* 1 OPPRESSION, *supra* note 8, at ch. 3 (discussing squeeze-out techniques).

For Texas cases, see Gibney v. Culver, No. 13-06-112-CV, 2008 WL 1822767, at *18 (Tex. App.—Corpus Christi Apr. 24, 2008, n.p.h.) (noting that the plaintiff had alleged that he was denied access to the books and records of the corporation, and stating that, "if true, this action would most certainly be construed as '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.'"); Redmon v. Griffith, 202 S.W.3d 225, 235 (Tex. App.—Tyler 2006, pet. denied) (stating that allegations of malicious suppression of dividends, using corporate funds for personal purposes, and "'squeeze-out' techniques

Quite often, these tactics are used in combination. For example, rather than declaring dividends, close corporations often distribute their earnings to shareholders in the form of salary and other employment-related compensation.[13] (Reasonable employment compensation is tax deductible to a corporation as a business expense, while dividend payments are not).[14] In a close corporation where dividends are not paid, therefore, a minority shareholder who is discharged from employment and removed from the board of directors is effectively denied any return on his investment as well as any input into the management of the business.[15] Such conduct often

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such as diverting corporate opportunities, excessive payment of dividends . . . and attempts to deprive the [plaintiffs] of the fair value of their shares and of the benefits thereof" would demonstrate a claim for shareholder oppression); *id.* at 236 ("Evidence concerning the use of corporate funds to pay personal expenses combined with evidence that [plaintiff] was denied access to the information concerning the financial condition of the corporation sufficiently creates a material fact issue concerning whether there was a lack of probity and fair dealing in the company's affairs to the prejudice of the [plaintiffs] or otherwise, a visible departure from the standards of fair dealing, and a violation of fair play on which minority shareholders like the [plaintiffs] were entitled to rely."); *id.* at 239 (noting that the minority shareholders alleged that they were wrongfully terminated from employment and that such terminations amounted to shareholder oppression, and concluding that the minority shareholders "have made sufficient allegations to demonstrate standing to proceed for wrongful termination within the confines of their shareholder oppression claim."); Gonzalez v. Greyhound Lines, Inc., 181 S.W.3d 386, 392 (Tex. App.—El Paso 2005, pet. denied) (noting that the alleged oppressive acts included "wrongfully terminating Appellants from their management positions and . . . fraudulently mismanaging [the corporation] to their detriment"); Christians v. Stafford, No. 14-99-00038-CV, 2000 WL 1591000, at *1-2 (Tex. App.—Houston [14th Dist.] Oct. 26, 2000, no pet.) (involving a trial court that found oppressive conduct based on a jury finding that the majority shareholder entered into lease agreements at less than fair value, but reversing on the grounds that insufficient evidence supported the finding); Advance Marine, Inc. v. Kelley, No. 01-90-00645-CV, 1991 WL 114463, at *1-2 (Tex.App.—Houston [1st Dist.] June 27, 1991, no pet.) (not designated for publication) (affirming a trial court finding that "the payment of inadequate dividends was misconduct requiring a buy-out"); *infra* Part III (discussing Texas cases).

13. *See, e.g.*, Landorf v. Glottstein, 500 N.Y.S.2d 494, 499 (Sup. Ct. 1986) (stating that, in a close corporation, "dividends are often provided by means of salaries to shareholders"); Hirschkorn v. Severson, 319 N.W.2d 475, 477 (N.D. 1982) ("[T]he corporation paid no dividends . . . . Rather, the corporate directors distributed the profits via salary increases, bonuses, and benefits . . . .").

14. When calculating its taxable income, a close corporation can deduct reasonable salaries paid to its employees to decrease the amount of income tax that the company pays. *See* 26 U.S.C. § 162(a)(1) (2000) (stating that "a reasonable allowance for salaries or other compensation for personal services actually rendered" is deductible). A close corporation cannot, however, deduct any dividends paid to its shareholders. As a consequence, corporate income paid as dividends is subject to double taxation—once as business income at the corporate level, and once as personal income at the shareholder level. As a result of the tax-disadvantaged nature of dividends, many close corporations forego "true" dividends and instead provide a return to shareholders via salary and other employment-related benefits. *See supra* note 13 and accompanying text.

15. *See, e.g.*, Balvik v. Sylvester, 411 N.W.2d 383, 388 (N.D. 1987) ("Balvik was ultimately fired as an employee of the corporation, thus destroying the primary mode of

culminates with a majority proposal to purchase the shares of the minority owner at an unfairly low price.[16] In short, this denial of financial and participatory rights is at the core of many lawsuits alleging that the majority used his control in an abusive or "oppressive" fashion against a minority shareholder.

In a public corporation, a minority shareholder can escape abusive majority conduct by selling his shares into the market and by correspondingly recovering the value of his investment. This ability to liquidate provides some protection to investors in public corporations from the conduct of those in control.[17] In a close corporation, however, the minority shareholder's investment is effectively trapped, as there is no ready market for the stock of a close corporation.[18] Thus, close corporation

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return on his investment. Any slim hope of gaining a return on his investment and remaining involved in the operation of the business was dashed when Sylvester removed Balvik as a director and officer of the corporation.").

16. *See, e.g.*, *Donahue*, 328 N.E.2d at 515 ("Majority 'freeze-out' schemes which withhold dividends are designed to compel the minority to relinquish stock at inadequate prices. When the minority stockholder agrees to sell out at less than fair value, the majority has won." (citations omitted)); Robert B. Thompson, *The Shareholder's Cause of Action for Oppression*, 48 BUS. LAW. 699, 703-04 (1993) (noting that in a classic freeze-out, "the majority first denies the minority shareholder any return and then proposes to buy the shares at a very low price").

17. *See, e.g.*, 2 F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL AND THOMPSON'S CLOSE CORPORATIONS AND LLCS: LAW AND PRACTICE § 9.2, at 9-5 (Rev. 3d ed. 2004) [hereinafter CLOSE CORPORATIONS] ("[A] shareholder in a close corporation does not have the exit option available to a shareholder in a publicly held corporation, who can sell [his] shares in a securities market if [he is] dissatisfied with the way the corporation is being operated."). Thompson, *supra* note 16, at 702 ("[T]he economic reality of no public market deprives investors in close corporations of the same liquidity and ability to adapt available to investors in public corporations.").

18. *See, e.g.*, Donahue v. Rodd Electrotype, 328 N.E.2d 505, 514 ("In a large public corporation, the oppressed or dissident minority stockholder could sell his stock in order to extricate some of his invested capital. By definition, this market is not available for shares in the close corporation."); Brenner v. Berkowitz, 634 A.2d 1019, 1027 (N.J. 1993) ("[U]nlike shareholders in larger corporations, minority shareholders in a close corporation cannot readily sell their shares when they become dissatisfied with the management of the corporation.").

A market is, of course, only one way to cash out of a company. Even without a market for a company's shares, a minority shareholder could still recover the value of his investment if he could force the corporation (or the majority shareholder) to purchase his shares on demand. No state's corporation law, however, provides such a right. Without an explicit buyout provision in a stockholders' agreement or a company's organizational documents, corporate shareholders have no right to compel a redemption of their holdings. *See, e.g.*, Goode v. Ryan, 489 N.E.2d 1001, 1004 (Mass. 1986) ("In the absence of an agreement among shareholders or between the corporation and the shareholder, or a provision in the corporation's articles of organization or by-laws, neither the corporation nor a majority of shareholders is under any obligation to purchase the shares of minority shareholders when minority shareholders wish to dispose of their interest in the corporation.").

Dissolution of a company can also provide liquidity to business owners by requiring the sale of the company and by allocating to each owner his proportionate share of the shareholders can be "locked-in" to the company, yet "frozen-out" from any business returns.[19]

III. THE CAUSE OF ACTION FOR SHAREHOLDER OPPRESSION

Over the years, state legislatures and courts have developed two significant avenues of relief for an oppressed close corporation shareholder. First, many state legislatures have amended their corporate dissolution statutes to include "oppression" by those in control as a ground for involuntary dissolution of the corporation.[20] Moreover, when oppressive conduct has occurred, courts have authorized alternative remedies that are less drastic than dissolution (e.g., buyouts, dividend orders, receivers).[21] Second, particularly in states without an oppression-triggered dissolution statute, some courts have imposed a fiduciary duty between close corporation

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company's sale value. *See Brenner*, 634 A.2d at 1031. If a minority shareholder in a close corporation had the right to compel dissolution, a mechanism for recovering the value of the invested capital would exist. In the close corporation setting, however, a minority shareholder has no default right to dissolve a corporation by "express will"— *i.e.*, voluntary dissolution usually requires the assent of at least a majority of the outstanding voting stock of a corporation. *See, e.g.*, TEX. BUS. CORP. ACT arts. 6.02, 6.03 (2003) (requiring at least a 2/3 vote of the outstanding shares); TEX. BUS. ORGS. CODE. §§ 21.364, 21.502, 21.503 (2008). For an oppressed minority shareholder, therefore, voluntary dissolution rights are largely unhelpful.

It is primarily for this reason (lack of exit rights) that the shareholder oppression doctrine is generally considered to be a close corporation doctrine. Only close corporation shareholders, in other words, tend to face the lack of exit rights that leave minority owners particularly vulnerable to oppressive conduct. Nevertheless, in *Redmon v. Griffith*, 202 S.W.3d 225, 234 (Tex. App.—Tyler 2006, pet. denied), the court stated that "[w]hile oppressive conduct is more easily found in the context of a close corporation, we are aware of no case law expressly limiting it to such a context."

19. Charles W. Murdock, *The Evolution of Effective Remedies for Minority Shareholders and its Impact Upon Valuation of Minority Shares*, 65 NOTRE DAME L. REV. 425, 431 (1990).

20. *See, e.g.*, Thompson, *supra* note 16, at 708 (discussing the dissolution statutes).

21. *See, e.g.*, Davis v. Sheerin, 754 S.W.2d 375, 380 (Tex. App.—Houston [1st Dist.] 1988, writ denied) ("[W]e hold that a court could order less harsh remedies [than liquidation] under . . . equity powers."); Brenner v. Berkowitz, 634 A.2d 1019, 1033 (N.J. 1993) ("Importantly, courts are not limited to the statutory remedies [for oppression], but have a wide array of equitable remedies available to them."); Balvik v. Sylvester, 411 N.W.2d 383, 388-89 (N.D. 1987) (listing alternative forms of relief for oppressive conduct such as appointing a receiver, granting a buyout, and ordering the declaration of a dividend); Masinter v. Webco Co., 262 S.E.2d 433, 441 & n.12 (W. Va. 1980) (listing ten possible forms of relief for oppressive conduct such as ordering the reduction of excessive salaries and issuing an injunction against further oppressive acts). *But see* Giannotti v. Hamway, 387 S.E.2d 725, 733 (Va. 1990) (stating that the dissolution remedy for oppression is "exclusive" and concluding that the trial court is not permitted "to fashion other . . . equitable remedies").

shareholders and have allowed an oppressed shareholder to bring a direct cause of action for breach of this duty.[22]

In Texas, the shareholder oppression precedents reflect both the statutory and the fiduciary duty developments. With respect to the statutory action for oppression, articles 7.05 and 7.06 of the Texas Business Corporation Act provide for the appointment of a receiver and the eventual possibility of liquidation when aggrieved shareholders can establish particular grounds, including "illegal, oppressive, or fraudulent" conduct by "directors or those in control."[23]

In *Davis v. Sheerin*,[24] the Houston Court of Appeals (1st) attempted to give some meaning to this oppressive conduct ground by citing the following two definitions:

> [1] [O]ppression should be deemed to arise only when the majority's conduct substantially defeats the expectations that objectively viewed were both reasonable under the circumstances and were central to the minority shareholder's decision to join the venture.
> [2] . . . [Oppressive conduct refers to] burdensome, harsh and wrongful conduct, a lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members, or a visible departure from the standards of fair dealing, and an [sic] violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.[25]

In *Davis*, the majority shareholder refused to recognize the minority shareholder's 45% ownership interest in the

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22. *See, e.g.*, Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 515, 518-19 (Mass. 1975); Crosby v. Beam, 548 N.E.2d 217, 221 (Ohio 1989); Thompson, *supra* note 16, at 726.

23. TEX. BUS. CORP. ACT arts. 7.05(A)(1)(c), 7.06 (2003) (emphasis added); *see* TEX. BUS. ORGS. CODE §§ 11.404(a)(1)(C), 11.405 (2008) (addressing oppressive conduct by "the governing persons of the entity").

24. 754 S.W.2d 375 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

25. *Id.* 381-82 (Tex. App.—Houston [1st Dist.] 1988) (internal quotation omitted); *accord* Gibney v. Culver, No. 13-06-112-CV, 2008 WL 1822767, at *16 (Tex. App.—Corpus Christi Apr. 24, 2008, n.p.h.); Cotten v. Weatherford Bancshares, Inc., 187 S.W.3d 687, 699-700 (Tex. App.—Fort Worth 2006, pet. denied); Redmon v. Griffith, 202 S.W.3d 225, 234 (Tex. App.—Tyler 2006, pet. denied); Gonzalez v. Greyhound Lines, Inc., 181 S.W.3d 386, 392 n.5 (Tex. App.—El Paso 2005, pet. denied); Willis v. Donnelly, 118 S.W.3d 10, 32 n.12 (Tex. App.—Houston [14th Dist.] 2003), *rev'd on other grounds*, 199 S.W.3d 262 (Tex. 2006); Allchin v. Chemic, Inc., No. 14-01-00433-CV, 2002 WL 1608616, at *8 (Tex. App.—Houston [14th Dist.] July 18, 2002, no pet.) (not designated for publication); Willis v. Bydalek, 997 S.W.2d 798, 801 (Tex. App.—Houston [1st Dist.] 1999, pet. denied).

corporation.[26] The majority claimed that the minority had previously relinquished his stockholdings to the majority as a gift.[27] The jury disagreed, as it found that the majority shareholder had conspired to deprive the minority shareholder of his ownership interest in the corporation.[28] Referencing the first definition of oppressive conduct, the *Davis* court stated that the majority's actions would "not only . . . substantially defeat any reasonable expectations [the minority shareholder] may have had . . . but would totally extinguish any such expectations."[29] In addition, the jury found that the majority shareholder had breached his fiduciary duty by making profit-sharing contributions solely for his own benefit, and by wasting corporate funds on his own attorneys' fees.[30] As a result of these findings, the *Davis* court affirmed the lower court's conclusion that oppressive conduct had occurred.[31] After noting that a court "could order less harsh remedies" than liquidation under its "general equity powers," the *Davis* court upheld an order requiring the majority shareholder to buy out the stockholdings of the minority shareholder at a jury-determined "fair value."[32]

In *Willis v. Bydalek*,[33] the Houston Court of Appeals (1st) again confronted a statutory action for shareholder oppression.[34] In *Willis*, a minority shareholder was fired from his employment with a close corporation.[35] The corporation paid no dividends,

26. *See Davis*, 754 S.W.2d at 377-78.

27. *See id.*

28. *See id.* at 382.

29. *Id.*

30. *See id.*

31. *See id.* at 383. It was, in fact, the court that determined that oppressive conduct had occurred. As the *Davis* court noted, "[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." *Id.* at 380.; *accord* Gibney v. Culver, No. 13-06-112-CV, 2008 WL 1822767, at *16 (Tex. App.—Corpus Christi Apr. 24, 2008, n.p.h.); Allchin v. Chemic, Inc., No. 14-01-00433-CV, 2002 WL 1608616, at *6-7 (Tex. App.—Houston [14th Dist.] July 18, 2002, no pet.) (not designated for publication); Willis v. Bydalek, 997 S.W.2d 798, 802 (Tex. App.—Houston [1st Dist.] 1999, pet. denied).

32. *Davis*, 754 S.W.2d at 379-81, 383. The *Davis* court also upheld various awards of damages, the appointment of a receiver, and an injunction prohibiting the majority shareholder from contributing to a profit-sharing plan unless a proportionate sum was paid to the minority shareholder. *See id.* at 378, 388.

33. 997 S.W.2d 798 (Tex. App.—Houston [1st Dist.] 1999, pet. denied).

34. The shareholder oppression claim in *Willis* likely derived from article 7.05 of the Texas Business Corporation Act rather than from common-law fiduciary duty notions. Indeed, although the minority shareholder alleged a claim for breach of fiduciary duty, such a claim was not submitted to the jury. *See id.* at 800. Instead, the jury granted relief to the minority shareholder on a separate claim of "wrongful lock-out"—a claim that presumably stemmed from the statutory action for shareholder oppression. *See id.* at 799, 802 n.2.

35. *See id.* at 799-800.

but the evidence indicated that the business had always been unprofitable.[36] In conducting its shareholder oppression analysis, the *Willis* court cited the two definitions of oppressive conduct that were noted in *Davis*.[37] After balancing "[the majority's] business judgment in the face of four profitless years of operation against the [minority's] reasonable expectations of participating in the business," the *Willis* court concluded that no oppressive conduct had occurred.[38] As the court stated, "we hold [that the majority] did not oppress [the minority] by firing him when (1) the jury found no wrong besides a [firing], (2) the corporation and [the majority shareholder], personally, always lost money, both before and after the [firing], and (3) the [minority shareholders] were at-will employees."[39]

In *Pinnacle Data Services, Inc. v. Gillen*,[40] the plaintiff was a member of a limited liability company ("LLC")[41] who sued two other members (as well as the LLC itself) for "member oppression."[42] The plaintiff alleged that the defendants engaged in member oppression by withholding profit distributions, terminating employment, failing to inform the plaintiff of company actions, and paying for individual legal fees with corporate funds.[43] After quoting the two definitions of oppressive conduct, the Texarkana Court of Appeals upheld the trial court's grant of summary judgment for the defendants on the ground that the plaintiff "failed to set forth any evidence in support of its claim for member oppression."[44] Significantly, the *Pinnacle* decision is devoid of any discussion of what would appear to be a threshold issue—i.e., whether the oppression doctrine can be extended from the close corporation setting to an LLC dispute. By citing the oppression definitions and proceeding to analyze

36. *See id.* at 800-02.

37. *See id.* at 801 (*citing* Davis v. Sheerin, 754 S.W.2d 375, 381-82 (Tex.App.—Houston [1st Dist.] 1988, writ denied)).

38. *Id.* at 802.

39. *Id.*

40. 104 S.W.3d 188 (Tex. App.—Texarkana 2003, no pet.).

41. For a brief definition of a limited liability company, *see infra* notes 135-36 and accompanying text. For more detail, see Douglas K. Moll, *Minority Oppression & The Limited Liability Company: Learning (or Not) from Close Corporation History*, 40 WAKE FOREST L. REV. 883, 917-25 (2005) (discussing the development of the LLC and its characteristics).

42. *See Pinnacle*, 104 S.W.3d at 191-92.

43. *See id.* at 196.

44. *Id.*

the claim (albeit summarily), the court seems to have accepted, at least implicitly, such an extension.[45]

In *Cotten v. Weatherford Bancshares, Inc.*,[46] plaintiff James Cotten owned preferred stock in Weatherford Bancshares, Inc. ("WBI"), a bank holding company.[47] He sued the directors of WBI (Joe Sharp and his daughter, Zan Sharp Statham) for shareholder oppression as well as other claims.[48] The gist of Cotten's oppression claim was that the director defendants had caused his preferred shares to be improperly redeemed.[49] The trial court dismissed Cotten's claim, holding as a matter of law that there can be no oppression between common shareholders and preferred shareholders.[50] The Fort Worth Court of Appeals noted that the trial court's holding "did not defeat Cotten's oppression cause of action . . . because he, a minority preferred shareholder, sued Sharp and Statham as directors of WBI, not as mere shareholders."[51] The court noted that "[b]ecause of the bank holding company structure, many internal conflicts are created that may lead to oppressive conduct," such as the conflict between directors and preferred shareholders.[52] As a result, the court held that "Cotten has a cause of action [for oppression] as a preferred shareholder against Sharp and Statham as directors of WBI."[53] The court also concluded that there was evidence to support Cotten's oppression claim:

45. For a legal basis under Texas law for such an extension, see *infra* notes 137-38 and accompanying text.

46. 187 S.W.3d 687 (Tex. App.—Fort Worth 2006, pet. denied).

47. *See id.* at 694.

48. *See id.* at 695. Cotten also brought a breach of fiduciary duty claim against Sharp and Statham. The court held that there was no evidence of a confidential relationship between Cotten and the defendants that would give rise to a fiduciary duty. *See id.* at 698-99. Although the court acknowledged that majority shareholders "are sometimes said to stand in a fiduciary relationship with both the corporation that they control and with the minority shareholders," it pointed out that "Sharp and Statham [did] not own any stock in WBI." *Id.* at 699 (noting that the corporation owned and controlled by Sharp and Statham was the majority shareholder of WBI, and that Cotten failed to sue the majority shareholder corporation). Finally, although the court observed that "[f]iduciary duties may be owed by those in control to preferred shareholders," the court intimated that such duties were contractually based, and that there was no evidence of any contractual fiduciary duties in the dispute. *See id.* As a result, the court upheld the trial court's granting of a directed verdict for the defendants on the breach of fiduciary duty claim. *See id.*

49. *See id.* at 700-01.

50. *Id.* at 699. Although the defendants were not common shareholders of WBI, they were the "majority common shareholders of the top-tier parent holding company" that indirectly owned WBI. *Id.* at 699-700.

51. *Id.* at 699; *see also id.* at 701 ("[W]e cannot hold that as a matter of law there can be no oppression between directors and preferred shareholders.").

52. *Id.* at 700.

53. *Id.*

> Sharp and Statham's improper redemption of the preferred shares, creating a financial benefit for themselves by decreasing the preferred share dividends that had to be paid out of capital they control, raises a fact issue regarding whether their conduct fits the second category of oppression—burdensome, harsh, or wrongful conduct; a lack of probity and fair dealing in the company's affairs to the prejudice of some members; or a visible departure from the standards of fair dealing and a violation of fair play on which each shareholder is entitled to rely.[54]

In *Gibney v. Culver*,[55] the plaintiff minority shareholder brought a statutory oppression action against Roy Culver, Jr., the chief executive officer of the corporation.[56] Based on jury findings that Culver had used his chief executive officer position to award excessive salaries and compensation to himself and members of his family, the trial court concluded that the plaintiff had been oppressed, and it awarded the plaintiff $250,000 in damages.[57] The Corpus Christi Court of Appeals reversed on insufficient evidence grounds.[58] The court emphasized that the plaintiff relied "solely on his listing of compensation for each individual, his own testimony that the salaries were 'shocking,' and his contention that persons [with] minimal credentials in Ingleside, Texas, should not make such salaries," and it concluded that "[t]his evidence is not enough."[59] The court also

54. *Id.* at 700-01.

55. No. 13-06-112-CV, 2008 WL 1822767 (Tex. App.—Corpus Christi Apr. 24, 2008, n.p.h.).

56. *See id.* at *1-2.

57. See *id.* at *1, 3-4.

58. *See id.* at *16.

59. *Id.* at *13. The *Gibney* court was heavily influenced by the Fifth Circuit's decision in *Rutter v. Commissioner of Internal Revenue*, 853 F.2d 1267 (5th Cir. 1988), which provided several factors for a reviewing court to consider in determining whether compensation is reasonable:

(1) the employee's qualifications;
(2) the nature, extent and scope of the employee's work;
(3) the size and complexities of the business;
(4) a comparison of salaries paid with gross income and net income;
(5) the prevailing general economic conditions;
(6) comparison of salaries with distributions to stockholders;
(7) the prevailing rates of compensation for comparable positions in comparable concerns;
(8) the salary policy of the taxpayer [corporation] as to all employees; and
(9) in the case of small corporations with a limited number of officers [,] the amount of compensation paid to a particular employee in previous years.

held that the jury's findings that dividends were not wrongfully withheld and that the plaintiff was not wrongfully prevented from inspecting the company's books and records were supported by the evidence.[60]

As mentioned, Texas cases also allow shareholders to challenge oppressive conduct as a breach of fiduciary duty. In *Patton v. Nicholas*,[61] T.W. Patton was the 60% owner of a close corporation.[62] The other two shareholders, J.W. Nicholas and Robert R. Parks, each owned 20% of the company's stock.[63] The corporation continuously earned profits and the net worth of the corporation steadily increased. Patton, however, refused to declare a dividend.[64] Nicholas and Parks eventually sued, alleging that Patton had committed fraud and abuse of his controlling position.[65] At trial, the jury found in part that Patton "wrongfully dominated and controlled the Board of Directors so as to prevent the declaration of dividends," and that Patton "did this for the sole purpose of preventing Nicholas and Parks from sharing in the profits to be derived from the operation of the corporation."[66] In affirming these jury findings, the Texas Supreme Court noted that "the malicious suppression of dividends is a wrong akin to a breach of trust, for which the courts will afford a remedy."[67] The court crafted a mandatory injunction requiring the corporation to pay a reasonable dividend "at the earliest practical date," as well as in future years.[68]

In *Duncan v. Lichtenberger*,[69] Waldron Duncan owned 60% of a close corporation that operated a night club.[70] C.F. Lichtenberger and D.M. Hogness each owned 20% of the corporation's shares.[71] When the company began to experience financial difficulties, Duncan discharged Lichtenberger and

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Gibney, 2008 WL 1822767, at *13-14 (citing *Rutter*, 853 F.2d at 1271). The court was also influenced by the proposition that "'the action of the Board of Directors of a corporation in voting salaries for any given period is entitled to the presumption that such salaries are reasonable and proper.'" *Id.* at 14 (quoting Mayson Mfg. Co. v. Comm'r of Internal Revenue, 178 F.2d 115, 119 (6th Cir. 1949)).

60. *See Gibney*, 2008 WL 1822767, at *17-18.
61. 279 S.W.2d 848 (Tex. 1955).
62. *See id.* at 849.
63. *See id.*
64. *See id*. at 849, 851-52.
65. *See id.* at 849.
66. *Id.* at 852.
67. *Id.* at 854.
68. *Id.* at 857.
69. 671 S.W.2d 948 (Tex. App.—Fort Worth 1984, writ ref'd n.r.e.).
70. See i*d.* at 953.
71. *See id.* at 950.

Hogness from their corporate positions.[72] Although Duncan continued to receive management fees and officer compensation, Lichtenberger and Hogness "never received any compensation as corporate officers and no dividends were ever distributed to shareholders."[73] In response to Duncan's actions, Lichtenberger and Hogness asserted that Duncan had breached a fiduciary duty owed directly to them.[74] The jury agreed, and damages were awarded to the two minority shareholders.[75] The Fort Worth Court of Appeals upheld the jury's findings, observing that "[t]he breach of a fiduciary duty is the type of wrong for which the courts of this State will afford a remedy."[76]

In *Allchin v. Chemic, Inc.*,[77] Steven Allchin brought a shareholder oppression claim against Walter Wadiak.[78] Allchin and Wadiak were both 50% shareholders in the corporation and they possessed equal voting rights.[79] In analyzing the oppression claim, the Houston Court of Appeals (14th) noted that "in certain limited circumstances, a majority shareholder who dominates control over a business may owe a fiduciary duty to the minority shareholder."[80] Nevertheless, the court expressed doubt over "whether a viable claim of shareholder oppression can exist" when the plaintiff and defendant are two 50% shareholders with equal voting rights.[81] The *Allchin* court, in other words, seemed to suggest that a controlling shareholder is absent when the plaintiff and the defendant are in relatively equivalent positions.[82] Nevertheless, the court continued its oppression

72. *See id.*

73. *Id.* at 951.

74. *See id.* at 949.

75. *See id.* at 951-52.

76. *Id.* at 953.

77. No. 14-01-00433-CV, 2002 WL 1608616 (Tex. App.—Houston [14th Dist.] July 18, 2002, no pet.) (not designated for publication).

78. *See id.* at *1.

79. *See id.* at *7.

80. *Id.* (citing Hoggett v. Brown, 971 S.W.2d 472, 488 n.13 (Tex. App.—Houston [14th Dist.] 1997, writ denied)).

81. *Id.* at *7.

82. *See id.* at *8 n.2 (stating that "we question whether breach of fiduciary duty should have been submitted to the jury when the evidence did not show [that defendant] was a controlling shareholder"); *id.* at *7 (noting that "[s]hareholder oppression is generally not available to a fifty percent owner" (italics removed)); *cf. In re* Webber, 350 B.R. 344, 364-65 (Bankr. S.D. Tex. 2006) (finding that no fiduciary duty was owed between two 50% shareholders in a close corporation, and suggesting that, even if a duty was owed, there was no breach—at least in part because the two men "were equal shareholders with equal access to the Company's books and records").

Despite *Allchin*, it should be noted that several courts have permitted one 50% shareholder to sue another 50% shareholder for oppression. *See, e.g.*, Hollis v. Hill, 232 F.3d 460, 463-64, 471 (5th Cir. 2000) (affirming the trial court's ruling that one 50%

analysis and ultimately concluded that "[n]o facts were proved . . . that would support a claim of shareholder oppression."[83] As part of its analysis, the court noted that "Allchin's complaints reflect disagreements about policy, and, as such, do not support a claim of shareholder oppression warranting a buy out," and it further stated that "[a]n employee who voluntarily leaves the employment of the corporation presents a less persuasive case for concluding the majority shareholders oppressed him."[84]

No case better reflects the statutory and fiduciary duty duality of Texas oppression law than *Redmon v. Griffith*.[85] In *Redmon*, the primary plaintiff, Jim Redmon, was an officer, director, and 25% shareholder of a close corporation, while the

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shareholder had oppressed the other 50% shareholder in a Nevada close corporation); Balsamides v. Protameen Chems., Inc., 734 A.2d 721, 722-24 (N.J. 1999) (involving a 50% shareholder who successfully sued the other 50% shareholder for oppression in a New Jersey close corporation); Bonavita v. Corbo, 692 A.2d 119, 123-24 (N.J. Super. Ct. Ch. Div. 1996) (noting that the thrust of the oppression statute is "protection from the abusive exercise of *power*," and allowing a 50% shareholder to sue the other 50% shareholder (who was also the president and chief executive officer) for oppression); Locati v. Johnson, 980 P.2d 173, 175 (Or. Ct. App. 1999) ("Indeed, one 50 percent owner can be a controlling shareholder with fiduciary duties to the other 50 percent owner."); Leech v. Leech, 762 A.2d 718, 718-20 (Pa. Super. Ct. 2000).

83. *Allchin*, 2002 WL 1608616 at *8 (italics removed).

84. *Id.* at *9. As the court observed:

> Allchin's claim of oppressive behavior rests on the following allegations regarding Wadiak's conduct prior to Allchin's resignation as an employee: not providing as much training as Allchin expected (although Wadiak provided training material and opportunities to work in the field); failing to use his talent and best effort to maximize [the corporation=s] success (e.g., drinking and not working a sufficient number of hours); failing to participate materially and contribute to the operation of the business . . .; failing to allow Allchin to participate and contribute to the management of the company (e.g., hiring an employee Allchin did not want to hire); and, using [the corporation] for personal gain (no examples provided). Allchin claims he was forced to resign as a result of Wadiak's conduct. Additionally, Allchin cites the following conduct by Wadiak after Allchin's resignation: failing to seek Allchin's consent for [the corporation's] proposed purchase of Allchin's stock and failing, after the break-in, to maintain [the corporation's] accounts in the bank designated in the Stock Sales Contract.
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> Although Allchin represents he was forced to resign as a result of Wadiak's conduct, Allchin's testimony describes a different scenario. . . . He . . . stated his termination was "voluntary," and explained, "I felt that I was in a dead-end scenario. There was never going to be a change." An employee who voluntarily leaves the employment of the corporation presents a less persuasive case for concluding the majority shareholders oppressed him.
>
> Additionally, the conduct Allchin alleges is distinguishable from cases in which courts held the facts established stockholder oppression. Instead, Allchin's complaints reflect disagreements about policy, and, as such, do not support a claim of shareholder oppression warranting a buy-out.

Id. (footnote omitted) (citations omitted).

85. 202 S.W.3d 225 (Tex. App.—Tyler 2006, pet. denied).

primary defendant, Ralph Griffith, was an officer, director, and 75% shareholder of the company. (Redmon's spouse was also a plaintiff, and Griffith's spouse was also a defendant).[86] The Redmons filed a lawsuit against the Griffiths asserting various individual actions, including claims for shareholder oppression and breach of fiduciary duty. The trial court granted summary judgment against the Redmons based partially on the ground that the Redmons lacked standing to assert individual claims.[87] The Tyler Court of Appeals disagreed, as it acknowledged that Texas courts have recognized "an individual cause of action for 'shareholder oppression' or 'oppressive conduct,'"[88] and it concluded that the Redmons had made "sufficient allegations, which taken as true, would demonstrate a claim for shareholder oppression."[89] The court further concluded that the Redmons had presented sufficient summary judgment evidence (i.e., evidence that the Griffiths used corporate funds to pay personal expenses and that Jim Redmon was denied access to corporate information) to create a genuine issue of material fact on the shareholder oppression action.[90]

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86. *See id.* at 231.

87. *See id.* at 231, 233.

88. *Id.* at 234 (citing cases).

89. *Id.* at 235. As the court stated:

> Specifically, the Redmons allege that the Griffiths have engaged in wrongful conduct; have not dealt in the company's affairs fairly to the prejudice of the Griffiths; and have not observed the standards of fair dealing on which each shareholder is entitled to rely. The Redmons also allege that the Griffiths maliciously suppressed the payment of dividends owed to them and made improper personal loans to themselves from [the corporation] in addition to paying personal expenses from corporate funds without the approval of the board of directors. Finally, the Redmons allege that the Griffiths employed 'squeeze out' techniques such as diverting corporate opportunities, excessive payment of dividends to themselves, and attempts to deprive the Redmons of the fair value of their shares and of the benefits thereof. We conclude that the Redmons have made sufficient allegations, which taken as true, would demonstrate a claim for shareholder oppression. We hold that the trial court's grant of summary judgment on the ground that the Redmons lacked standing to proceed on their claim for shareholder oppression was improper.

Id. (citations omitted).

90. *See id.* at 236. As the court observed:

> We conclude that the Redmons presented sufficient evidence to overcome the Griffiths' motion for summary judgment concerning their claim of shareholder oppression. Evidence concerning the use of corporate funds to pay personal expenses combined with evidence that Jim Redmon was denied access to information concerning the financial condition of the corporation sufficiently creates a material fact issue concerning whether there was a lack of probity and fair dealing in the company's affairs to the prejudice of the Redmons or otherwise, a visible departure from the standards of fair dealing, and a violation of fair play on which minority shareholders like the Redmons were entitled to rely. We hold that the trial court incorrectly granted summary judgment on the Redmons claim for shareholder oppression.

With respect to the breach of fiduciary duty claim, the Redmons alleged that "[t]he acts of the individual Defendants in exercising and engaging in the oppressive and 'squeeze-out' tactics" constituted a breach of the majority shareholder's fiduciary duty—a duty owed directly to individual minority shareholders.[91] The *Redmon* court explained that "[a] coshareholder in a closely held corporation does not as a matter of law owe a fiduciary duty to his coshareholder[,]" and it noted that "the existence of such a duty depends on the circumstances."[92] Nevertheless, the court also observed that fiduciary duties to shareholders may be created "in certain circumstances in which a majority shareholder in a closely held corporation dominates control over the business, and in closely held corporations in which the shareholders operate more as partners than in strict compliance with the corporate form."[93] The court pointed out that the Redmons had alleged (1) the existence of a majority-minority shareholder relationship between the Redmons and the Griffiths; (2) that the corporation was closely held; and (3) that Ralph Griffith exercised a great deal of control over the business.[94] As the court concluded, "[s]uch allegations combined with allegations in the Redmons' pleadings that the Griffiths engaged in wrongful conduct and a lack of fair dealing with regard to the company's affairs to the prejudice of the Redmons sufficiently alleges a breach of fiduciary duty by way of oppressive conduct."[95] Thus, based on the allegations of oppression, the *Redmon* court upheld both a statutory oppression claim and a breach of fiduciary duty claim

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Id.

91. *Id.* The Redmons also alleged that the defendants' conduct violated fiduciary duties that the defendants owed as officers and directors. The court rejected that claim:

> [T]hey have sought a distinct avenue of recovery from the Griffiths based on allegations that they violated their fiduciary duties as officers and directors of [the corporation]. Such allegations allege a breach of duty owed to the corporation. As such, since they have not alleged the breach of a legal duty owed to them individually, no cause of action can accrue to their benefit therefrom.

Id. at 237; *see also id.* at 233 ("Traditionally, a corporate officer owes a fiduciary duty to the shareholders collectively, *i.e.*, the corporation, but he does not occupy a fiduciary relationship with an individual shareholder unless some contract or special relationship exists between them in addition to the corporate relationship.").

92. *Id.* at 237.

93. *Id.*; *accord* Willis v. Donnelly, 118 S.W.3d 10, 31-32 (Tex. App.—Houston [14th Dist.] 2003, *rev'd on other grounds*, 199 S.W.3d 262 (Tex. 2006)).

94. *See Redmon*, 202 S.W.3d at 237-38.

95. *Id.* at 238.

as actions that an individual shareholder could properly assert on his own behalf.[96]

IV. IMPLICATIONS OF THE SHAREHOLDER OPPRESSION DOCTRINE

A. *A Limitation on Employment at Will*

Because employment is often the vehicle for distributing the profits of a close corporation,[97] a decision to terminate the employment of a minority shareholder may be considered oppressive, even if the minority shareholder can also be characterized as an at-will employee. Indeed, numerous courts, including *Duncan*, have granted oppression-based relief to minority shareholders challenging their terminations from close corporation employment.[98] Even the First Court of Appeals noted in *Willis* that "[w]e are not holding that firing an at-will employee who is a minority shareholder can never, under any circumstances, constitute shareholder oppression; we simply hold that under these particular facts, it does not."[99] Although the *Willis* court referenced the employment at will doctrine in stating that "expectations of continued employment that are contrary to well settled law cannot be considered 'objectively reasonable,'"[100] the court seemed to suggest that oppression liability could arise when a minority shareholder is terminated from a profitable corporation, at least to the extent that the termination precludes the minority shareholder from receiving his proportionate share of the business returns.[101] In the later *Redmon* decision, the

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96. *See id.* at 242.

97. *See supra* note 13 and accompanying text.

98. *See, e.g.*, Duncan v. Lichtenberger, 671 S.W.2d 948, 950-51, 953 (Tex. App.—Fort Worth 1984, writ ref'd n.r.e.) (involving the "firing" of two minority shareholders); *see also* W&W Equip. Co. v. Mink, 568 N.E.2d 564, 574 (Ind. Ct. App. 1991) (acknowledging the employment at will rule but affirming a breach of fiduciary duty finding); Pedro v. Pedro, 463 N.W.2d 285, 289 (Minn. Ct. App. 1990) ("In a closely held corporation the nature of the employment of a shareholder may create a reasonable expectation by the employee-owner that his employment is not terminable at will."); *Redmon*, 202 S.W.3d at 238 ("[T]he possibility exists that the firing of an at-will employee who is a minority shareholder can constitute shareholder oppression."); Douglas K. Moll, *Shareholder Oppression v. Employment at Will in the Close Corporation: The Investment Model Solution*, 1999 U. ILL. L. REV. 517, 531 n.65, 559 & n.167 (1999) (citing cases).

99. Willis v. Bydalek, 997 S.W.2d 798, 802 (Tex. App.—Houston [1st Dist.] 1999, pet. denied).

100. *Id.* at 803.

101. *See id.* at 802 (emphasizing that the corporation and the majority shareholder always lost money, and distinguishing contrary authority on the grounds that they involved profitable corporations and majority shareholders who received compensation or other corporate benefits to the exclusion of the minority shareholder).

Tyler Court of Appeals stated even more directly that "[t]he possibility exists that the firing of an at-will employee who is a minority shareholder can constitute shareholder oppression."[102]

B. *The End of Business Judgment Rule Deference*

The business judgment rule is a fundamental principle of corporate law that generally precludes courts from interfering with directors' business decisions that have been made in good faith, with ordinary care, and with no conflicts of interest.[103] When the business judgment rule applies, judicial scrutiny of a board's substantive business decision is practically non-existent. The directors are entitled to prevail when their actions are challenged so long as they can articulate any rational business purpose for their conduct.[104] As a result of this rule, judicial interference with board decisions involving employment, management, or dividend matters is rare.[105]

For an argument that a minority shareholders termination could be oppressive even if (1) the corporation is unprofitable, or (2) the discharged shareholder is still receiving his proportionate share of the business returns, *see* Moll, *supra* note 98, at 536-68.

102. *Redmon*, 202 S.W.3d at 238; see *id.* at 239 (concluding that the minority shareholders "have made sufficient allegations to demonstrate standing to proceed for wrongful termination within the confines of their shareholder oppression claim").

103. *See, e.g.*, FDIC v. Wheat, 970 F.2d 124, 130-31 & n.13 (5th Cir. 1992)(applying Texas law); Cates v. Sparkman, 11 S.W. 846, 849 (Tex. 1889); *see also* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (noting that the business judgment rule operates to shield a manager from liability so long as the manager's decision was made "on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company").

104. *See, e.g.*, *Wheat*, 970 F.2d at 130-31 & n.13 (applying Texas law); *see also* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) ("A board of directors enjoys a presumption of sound business judgment, and its decisions will not be disturbed if they can be attributed to any rational business purpose."); Krishnan S. Chittur, *Resolving Close Corporation Conflicts: A Fresh Approach*, 10 HARV. J.L. & PUB. POL'Y 129, 154 (1987) ("So long as the controlling stockholder's conduct is not outrageous—that is, a plausible business reason can be articulated—his decisions are protected by the business judgment rule.").

105. *See, e.g.*, Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657, 662 (Mass. 1976) ("[C]ourts fairly consistently have been disinclined to interfere in those facets of internal corporate operations, such as the selection and retention or dismissal of officers, directors and employees, which essentially involve management decisions subject to the principle of majority control."); Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 513 (Mass. 1975) ("[T]he plaintiff will find difficulty in challenging dividend or employment policies. Such policies are considered to be within the judgment of the directors." (footnote omitted)); *see also* Ralph A. Peeples, *The Use and Misuse of the Business Judgment Rule in the Close Corporation*, 60 NOTRE DAME L. REV. 456, 469, 477 (1985) ("The declaration of dividends is always at the discretion of the board of directors. The business judgment rule protects such a decision."(footnote omitted)); *id.* at 477 ("The hiring, firing, and compensation of employees are ultimately board decisions and have always qualified as management decisions protected by the business judgment rule.").

As mentioned, however, the shareholder oppression doctrine recognizes that decisions about such matters by a majority-controlled board can be part of a minority shareholder freeze-out.[106] The oppression doctrine, therefore, is implicitly premised upon the notion that close corporation employment, management, and dividend decisions require more than a mere surface inquiry into the majority's conduct. Indeed, the fact that courts applying the oppression doctrine are subjecting the majority's actions to "reasonable expectations" or "burdensome, harsh, and wrongful conduct" standards suggests that courts are requiring majority shareholders to do more than merely articulate a rational business purpose for their decisions.[107] In fact, some courts have explicitly acknowledged that majority shareholder decisions in close corporations call for more judicial scrutiny than conventional business judgment rule deference.[108]

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106. *See supra* notes 7-12 and accompanying text.

107. *See e.g.,* O'Donnel v. Marine Repair Servs., 530 F. Supp. 1199, 1205-08 (S.D.N.Y. 1982) (rejecting defendants' asserted business justification as pretextual); *cf.* Zimmerman v. Bogoff, 524 N.E.2d 849, 854 (Mass. 1988) (same); Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657, 663-64 (Mass. 1976) (concluding that the controlling shareholders' employment and management decisions were improper because there was no evidence of a legitimate business purpose for the actions).

108. *See, e.g.*, Smith v. Atl. Props., Inc., 422 N.E.2d 798, 801, 804 (Mass. App. Ct. 1981) (stating, in a close corporation dispute, that "[t]he judgment . . . necessarily disregards the general judicial reluctance to interfere with a corporation's dividend policy ordinarily based upon the business judgment of its directors"); Fox v. 7L Bar Ranch Co., 645 P.2d 929, 935 (Mont. 1982) ("When it is also considered that in close corporations dividend withholding may be used by controlling shareholders to force out minority shareholders, the traditional judicial restraint in interfering with corporate dividend policy cannot be justified." (citation omitted)); Grato v. Grato, 639 A.2d 390, 396 (N.J. Super. Ct. App. Div. 1994) ("[J]udicial consideration of a claim of majority oppression or freeze-out in a closely held corporation is guided by considerations broader than those espoused in defendants' version of the 'business judgment rule.'"); Exadaktilos v. Cinnaminson Realty Co., 400 A.2d 554, 561 (N.J. Super. Ct. Law Div. 1979) ("[T]he statutory language embodies a legislative determination that freeze-out maneuvers in close corporations constitute an abuse of corporate power. Traditional principles of corporate law, such as the business judgment rule, have failed to curb this abuse. Consequently, actions of close corporations that conform with these principles cannot be immune from scrutiny."); *see also* Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 293 (1986) ("It makes sense, therefore, to have greater judicial review of terminations of managerial (or investing) employees in closely held corporations than would be consistent with the business judgment rule. The same approach could be used with salary, dividend, and employment decisions in closely held corporations where the risks of conflicts of interest are greater."); *cf.* Hollis v. Hill, 232 F.3d 460, 467 (5th Cir. 2000) ("In the context of a closely held corporation, many classic business judgment decisions can also have a substantial and adverse [e]ffect on the 'minority's' interest as shareholder."). *But see* Brenner v. Berkowitz, 634 A.2d 1019, 1033 (N.J. 1993) (noting, in a close corporation dispute, that "the court is hesitant to overturn the corporation's valued exercise of its business judgment," and observing that "[t]he Chancery Division properly concluded that it could not second-guess the corporation's exercise of its business-judgment"); Willis v. Bydalek, 997 S.W.2d 798, 801 (Tex. App.—Houston [1st Dist.] 1999, pet. denied) ("Courts must

C. *Avoidance of Derivative Requirements*

Texas precedents indicate that a majority shareholder's fiduciary duty ordinarily runs to the corporation and not to the individual shareholders.[109] Actions alleging breach of the

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exercise caution in determining what shows oppressive conduct. The minority shareholder's reasonable expectations must be balanced against the corporation's need to exercise its business judgment and run its business efficiently. Therefore, despite the existence of the minority-majority fiduciary duty, a corporation's officers and directors are still afforded a rather broad latitude in conducting corporate affairs." (citations omitted)).

The conclusion of courts that business judgment rule deference is inappropriate in the close corporation context can be justified on a number of grounds. First, the absence of a public market in the close corporation setting weakens the justification for applying the business judgment rule as poor managerial decisions are not constrained by market-driven threats of displacement. *See* Douglas K. Moll, *Shareholder Oppression & Dividend Policy in the Close Corporation*, 60 WASH. & LEE L. REV. 841, 864-67 (2003) (discussing how the presence of a market diminishes the need for judicial review).

Second, oppression disputes tend to involve subtle (if not explicit) conflicts of interest—the presence of which bar the application of the business judgment rule under traditional corporate law. *See supra* notes and accompanying text 25, 103; *see also* Brehm v. Eisner, 746 A.2d 244, 264 n.66 (Del. 2000) ("The business judgment rule has been well formulated by . . . other cases. Thus, directors' decisions will be respected by courts unless *the directors are interested or lack independence relative to the decision*, do not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process that includes the failure to consider all material facts reasonably available." (emphasis added) (citation omitted)). For example, because employment is often the vehicle for distributing profits in a close corporation, see *supra* note 13 and accompanying text, the termination of a minority shareholder's employment can be a mechanism for the majority to appropriate a disproportionate share of the company's income stream to himself. *See* Nagy v. Riblet Prods. Corp., 79 F.3d 572, 577 (7th Cir. 1996) ("Many closely held firms endeavor to show no profits (to minimize their taxes) and to distribute the real economic returns of the business to the investors as salary. When firms are organized in this way, firing an employee is little different from canceling his shares."). Similarly, whereas a majority-directed decision to withhold dividends may affect all shares in the same manner, the decision in a close corporation may be motivated by the majority's personal desire to retain capital so that his own employment position with the company can be preserved and enhanced. *See, e.g.*, Moll, *supra*, at 867-69, 900-01 (discussing the majority's personal desire to maximize the value of his employment capital in a close corporation and suggesting that such a desire presents a conflict of interest when the majority decides to forego dividends). Withholding dividends may also be an effort to coerce a minority shareholder to sell out to the majority at an unfairly low price. *See, e.g.*, Litle v. Waters, Civ. A. No. 12155, 1992 WL 25758, at *8 (Del. Ch. Feb. 11, 1992) (describing the plaintiff's allegation "that the company was rich with cash and that the only reason that the company did not make dividends was to aid [the majority] to buy [the minority] out for less than fair value"); Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657, 664 (Mass. 1976) ("[W]e may infer that a design to pressure [the minority] into selling his shares to the corporation at a price below their value well may have been at the heart of the majority's plan."). In short, because subtle conflicts of interest (at least) are present in the typical shareholder oppression dispute, the deference of the business judgment rule is inappropriate.

109. *See* Schautteet v. Chester State Bank, 707 F. Supp. 885, 888-89 (E.D. Tex. 1988) (noting that "most abuses of majority control constitute breaches of the fiduciary duties the majority owes to the corporation, just as officers and directors owe fiduciary duties solely to the corporation"); Hoggett v. Brown, 971 S.W.2d 472, 488 n.13 (Tex. App.—Houston [14th Dist.] 1997, writ denied) (noting that "a majority shareholder's fiduciary

majority's fiduciary duty, therefore, are often brought as "derivative" lawsuits on behalf of the corporation.[110] In such lawsuits, the aggrieved shareholder "brings suit in the name of the corporation to redress the defendant's breach of duty to the corporation and the shareholders as a whole."[111] Derivative actions can be perilous, however, as they require the plaintiff shareholder to comply with a number of procedural requirements. For example, the derivative plaintiff must typically (1) possess an ownership interest in the corporation at the time of the alleged wrong; (2) represent fairly and adequately the interests of the corporation; and (3) make a demand upon the corporation's board to take suitable action against the wrongdoers.[112] Failure to comply with these requirements can result in the dismissal of the lawsuit.[113]

In close corporations, however, there are precedents in Texas and in other jurisdictions involving a fiduciary duty owed by majority shareholders directly to minority shareholders.[114] Indeed, although Texas cases repeatedly state that "'[a] co-shareholder in a closely held corporation does not as a matter of law owe a fiduciary duty to his co-shareholder,'"[115] and that "the

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duty ordinarily runs to the corporation," but stating that "in certain limited circumstances, a majority shareholder who dominates control over the business may owe such a duty to the minority shareholder"); *see also* J.A.C. Hetherington & Michael P. Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1, 12 & n.30 (1977) (mentioning that under the traditional view duties run "solely between the majority and the corporation," and further observing that "[t]he notion that the fiduciary obligations of management run only to the corporation provides the minority in close corporations virtually no protection against oppression and exploitation by the control group").

110. *See, e.g.*, Thompson, *supra* note 16, at 729-30; *see also* Providential Inv. Corp. v. Dibrell, 320 S.W.2d 415, 418 (Tex. Civ. App.—Houston 1959, no writ) (describing a derivative lawsuit); 3 BARBARA BADER ALDAVE, TEXAS CORPORATIONS: LAW AND PRACTICE § 122.01[2], at 122-5 (1995) (same); *id.* § 122.02[1], at 122-9 (noting that, in a derivative action, "the cause of action belongs to the corporation").

111. Thompson, *supra* note 16, at 730.

112. *See* TEX. BUS. CORP. ACT art. 5.14(B), (C) (Supp. 2003); TEX. BUS. ORGS. CODE §§ 21.552-53 (2008); TEX. R. CIV. P. 42; ALDAVE, *supra* note 110, § 122.02, at 122-8.1 to 122-15.

113. *See, e.g.*, Dodson v. Kung, 717 S.W.2d 385, 390 (Tex. App.—Houston [14th Dist.] 1986, pet. denied).

114. *See, e.g.*, *Redmon*, 202 S.W.3d at 236-38; Hoggett v. Brown, 971 S.W.2d 472, 488 n.13 (Tex. App.—Houston [14th Dist.] 1997, pet. denied) (citing Texas cases); Alexander v. Sturkie, 909 S.W.2d 166, 170 n.2 (Tex. App.—Houston [14th Dist.] 1995, writ denied); *supra* note 22 and accompanying text; *infra* note 119 and accompanying text; *see also* Gibney v. Culver, No. 13-06-112-CV, 2008 WL 1822767, at *17 (Tex. App.—Corpus Christi Apr. 24, 2008, n.p.h.) ("Additionally, majority shareholders are sometimes said to stand in a fiduciary relationship with both the corporation that they control and with minority shareholders.").

115. Willis v. Donnelly, 118 S.W.3d 10, 31 (Tex. App.—Houston [14th Dist.] 2003) (quoting Hoggett v. Brown, 971 S.W.2d 472, 488 (Tex. App.—Houston [14th Dist.] 1997,

existence of such a duty depends on the circumstances,"[116] courts have also observed that fiduciary duties may be created "in certain circumstances in which a majority shareholder in a closely held corporation dominates control over the business"[117]—a situation that will occur in nearly every oppression dispute. Moreover, Texas courts have stated that a fiduciary duty may arise "in closely held corporations in which the shareholders 'operate more as partners than in strict compliance with the corporate form'"[118] a category that would again seem to encompass nearly every oppression dispute. Because this fiduciary duty runs to minority shareholders individually, courts have allowed the duty to be enforced in a direct action rather than in a derivative proceeding.[119] As a consequence, minority

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writ denied)), *rev'd on other grounds*, 199 S.W.3d 262 (Tex. 2006); *accord Redmon*, 202 S.W.3d at 237; *see also Willis*, 118 S.W.3d at 33 n.16 ("It is error for a trial court to instruct a jury that shareholders in a closely held corporation owe each other a fiduciary duty as a matter of law.").

116. *Willis*, 118 S.W.3d at 31; *accord* Lakewood Devs. Corp. v. Schultheis, No. 4:03-CV-1224-A, 2004 WL 764729, at *7 (N.D. Tex. Apr. 6, 2004); *Redmon*, 202 S.W.3d at 237.

117. *Willis*, 118 S.W.3d at 31-32; *accord Redmon*, 202 S.W.3d at 237; Allchin v. Chemic, Inc., No. 14-01-00433-CV, 2002 WL 1608616, at *7 (Tex. App.—Houston [14th Dist.] July 18, 2002, no pet.) (not designated for publication); Hoggett v. Brown, 971 S.W.2d 472, 488 n.13 (Tex. App.—Houston [14th Dist.] 1997, writ denied).

118. Willis v. Donnelly, 118 S.W.3d 10, 32 (Tex. App.—Houston [14th Dist.] 2003) (quoting DeBord v. Circle Y, Inc., 951 S.W.2d 127, 133 (Tex. App.—Corpus Christi 1997), *rev'd on other grounds sub nom.* Stary v. DeBord, 967 S.W.2d 352, 354 (Tex. 1998)), *rev'd on other grounds*, 199 S.W.3d 262, (Tex. 2006); *accord Redmon*, 202 S.W.3d at 237.

In Willis v. Donnelly, 199 S.W.3d 262 (Tex. 2006), the Texas Supreme Court passed on the opportunity to consider these fiduciary duty pronouncements. As the court observed:

> A host of legal questions are raised by [the plaintiff's] claim, including the issues of (1) whether a majority shareholder in a closely held corporation[] owes a minority shareholder a general fiduciary duty under Texas law, [and] (2) whether a distinction must be drawn between breach of a duty owed to a minority shareholder qua shareholder and malfeasance by a majority shareholder, such as usurpation of a corporate opportunity, that would only give rise to a shareholder derivative action on behalf of the corporation. . . . We do not explore these issues, but hold instead that the breach of fiduciary duty claim in the pending case fails because all the alleged breaches of fiduciary duty occurred before [the plaintiff] became a shareholder and before he was entitled to shareholder status. There can be no liability for alleged breaches of a duty that occurred before the duty arose.

Id. at 276-77; *see id.* at 277 (noting that "[t]he only conceivable basis for a fiduciary relationship in this case would be a duty owed by a majority shareholder to a minority shareholder," and stating that "[a]ssuming without deciding that such a relationship can give rise to a general fiduciary duty, we decline to recognize the existence of such a duty on this record").

119. *See, e.g.*, Patton v. Nicholas, 279 S.W.2d 848, 849 (Tex. 1955); Redmon v. Griffith, 202 S.W.3d 225, 236-38 (Tex. App.—Tyler 2006, pet. denied); Willis v. Donnelly, 118 S.W.3d 10, 34-35 (Tex. App.—Houston [14th Dist.] 2003) (rejecting the assertion that plaintiff was required to bring a derivative lawsuit because he alleged a breach of fiduciary duty owed directly to him as a minority shareholder in a close corporation), *rev'd*

shareholders in close corporations have been able to assert claims for breach of fiduciary duty (e.g., claims that controlling shareholders have misappropriated assets or have received excessive compensation) on their own behalf without needing to comply with the procedural hurdles accompanying a derivative lawsuit.[120] Thus, the associated risk of dismissal on these procedural grounds is eliminated. Article 5.14(L) of the Texas Business Corporation Act supports this position by noting that most of the procedural requirements for derivative suits are not applicable to a "closely held corporation," and by stating that "[i]f justice requires . . . a derivative proceeding brought by a shareholder of a closely held corporation may be treated by a court as a direct action brought by the shareholder for his own benefit."[121]

D. *A "Way Out": The Buyout Remedy*

For a plaintiff, perhaps the single most attractive feature of the oppression doctrine is its remedial flexibility. As mentioned, courts have authorized a wide variety of alternative remedies that are less drastic than dissolution, often citing their equitable authority as the basis for such remedies.[122] The most common

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on other grounds, 199 S.W.3d 262, 276-77 (Tex. 2006); Joseph v. Koshy, No. 01-98-01432-CV, 2000 WL 124685, at *4 (Tex. App.—Houston [1st Dist.] Feb. 3, 2000, no pet.) (not designated for publication) (stating that plaintiff minority shareholders' allegations of oppression and breach of fiduciary duty "were individual [actions] and did not belong to the corporation," and concluding, as a result, that compliance with derivative lawsuit requirements was unnecessary); *id.* (noting that plaintiff minority shareholders alleged "breach of a fiduciary duty owed to them" and stating that "[c]ourts have recognized minority shareholders' *individual* causes of action for oppressive conduct and breach of fiduciary duty" (emphasis added)); Debord v. Circle Y, Inc., 951 S.W.2d 127, 133-34 (Tex. App.—Corpus Christi 1997) ("Consequently, claims of oppressive conduct arising out of the fiduciary duties owed by the majority shareholders to the minority shareholders are, in our opinion, individual claims of the minority shareholders."), *rev'd on other grounds sub nom.* Stary v. DeBord, 967 S.W.2d 352, 352 (Tex. 1998)); Davis v. Sheerin, 754 S.W.2d 375, 377-78 (Tex. App.—Houston [1st Dist.] 1988, writ denied); Duncan v. Lichtenberger, 671 S.W.2d 948, 949 (Tex. App.—Fort Worth 1984, writ ref'd n.r.e.). *But see* Faour v. Faour, 789 S.W.2d 620, 622-23 (Tex. App.—Texarkana 1990, writ denied) (distinguishing *Patton*, *Davis*, and *Duncan*).

120. *See, e.g.*, Thompson, *supra* note 16, at 735-37 (citing cases); *supra* note 109 and accompanying text.

Given the somewhat unclear state of fiduciary duty law in Texas close corporations, *see supra* notes 115-18 and accompanying text, it is often easier for plaintiffs to pursue the statutory action for oppression, as the statute automatically grants standing to any shareholder who challenges abusive conduct by "directors or those in control." The statute, in other words, imposes a duty on those who control the corporation to not act oppressively- a duty that runs, as a matter of law, to any shareholder in the corporation.

121. TEX. BUS. CORP. ACT 5.14(L) (Supp. 2008); *see* TEX. BUS. ORGS. CODE § 21.563 (2008).

122. *See supra* note 21 and accompanying text.

remedy for oppressive conduct, however, is a buyout of the oppressed investor's shares—a remedy that Texas courts have explicitly authorized.[123] In operation, a buyout typically involves a court ordering the corporation or the majority shareholder to purchase the shares of an aggrieved minority investor at a judicially-determined "fair value."[124] The court or jury, usually aided by experts, values the company and awards the minority shareholder his proportionate share of the corporation's value (subject to any applicable discounts). In effect, the buyout remedy provides a judicially-created exit for an aggrieved shareholder by allowing the shareholder to recover the capital that he invested in the venture.

In general, a buyout is advantageous because it provides a mechanism for a shareholder to extricate his investment from a venture without having to dissolve the corporation. The remaining shareholders continue to operate the business and to participate in the company's successes and failures, while the departing shareholder recovers the value of his invested capital and removes himself from the company's affairs. This equitable "parting" avoids a number of practical problems that often arise when more conventional remedies (e.g., injunctions or damages) are considered.[125]

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123. *See* Douglas K. Moll, *Shareholder Oppression in Close Corporations: The Unanswered Question of Perspective*, 53 VAND. L. REV. 749, 792 (2000) ("The most prevalent alternative remedy is the buyout of the oppressed investor's holdings."); *see also* Christians v. Stafford, No. 14-99-00038-CV, 2000 WL 1591000, at *2 (Tex. App.-Houston [14th Dist.] Oct. 26, 2000, no pet.) (not designated for publication) (noting that "a court may order an equitable 'buy-out' of a party's minority shares for oppressive acts of the majority"); Advance Marine, Inc. v. Kelley, No. 01-90-00645-CV, 1991 WL 114463, at *2 (Tex. App.—Houston [1st Dist.] June 27, 1991, no pet.) (not designated for publication) ("Courts have power to order the equitable remedy of a buy-out by the majority shareholders according to the facts of the particular case."); Davis v. Sheerin, 754 S.W.2d 375, 378, 380-81 (Tex. App.—Houston [1st Dist.] 1988, writ denied) (upholding a buyout at fair value and stating 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").

124. *See, e.g.*, Davis v. Sheerin, 754 S.W.2d 375, 381, 383 (Tex. App.—Houston [1st Dist.] 1988, writ denied) (upholding a buyout at fair value and noting that "[a]n ordered 'buyout' of stock at its fair value is an especially appropriate remedy in a closely-held corporation, where the oppressive acts of the majority are an attempt to 'squeeze out' the minority, who do not have a ready market for the corporation's shares, but are at the mercy of the majority").

125. *See, e.g.*, Douglas K. Moll, *Reasonable Expectations v. Implied-in-Fact Contracts: Is the Shareholder Oppression Doctrine Needed?*, 42 B.C. L. REV. 989, 1019-21 (2001) (noting that injunctions are often problematic because they force the parties to continue working together, and observing that damage awards can be similarly problematic because they "keep the investment of the aggrieved shareholder locked into the company and, relatedly, force the aggrieved shareholder to trust that a previously oppressive majority shareholder will not oppress again").

An issue that inevitably arises in the buyout setting is the meaning of "fair value" and the corresponding propriety of discounts.[126] Broadly speaking, two conflicting approaches have developed. The first approach equates fair value with "fair market value." Under this view, a court values an oppressed minority's shares by considering what a hypothetical purchaser would pay for them.[127] Because minority shares, by definition, lack control, a hypothetical purchaser is likely to pay less for minority shares than it would for shares that possess control (the "minority discount").[128] Moreover, because close corporation shares lack a ready market and are, as a consequence, difficult to liquidate, a hypothetical purchaser is likely to pay less for close corporation shares than it would for readily traded public corporation shares (the "marketability discount").[129] Under the

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126. *See generally* Douglas K. Moll, *Shareholder Oppression & "Fair Value": Of Discounts, Dates, and Dastardly Deeds in the Close Corporation*, 54 DUKE L.J. 293-366 (2004) [hereinafter *Fair Value*] (providing a detailed discussion of the meaning of fair value and the propriety (or impropriety) of discounts).

Another issue that often arises in the buyout setting is the choice of the valuation date. In *Hollis v. Hill*, 232 F.3d 460, 472 (5th Cir. 2000), the court stated that "[t]he presumptive valuation date for other states allowing buy-out remedies is the date of filing [of the oppression lawsuit] unless exceptional circumstances exist which require an earlier or later date to be chosen." *Id.* at 472; *see also Fair Value*, *supra*, at 366-83 (discussing the valuation date).

127. More precisely, fair market value is defined as "the price at which property would change hands between a willing buyer and a willing seller when neither party is under an obligation to act." Pueblo Bancorporation v. Lindoe, Inc., 63 P.3d 353, 362 (Colo. 2003).

128. The "minority discount" reflects the simple fact that "investors value the ability to direct management and thus would not be willing to pay as much for shares on a minority basis as they would for shares that convey a controlling interest." John D. Emory, Jr., Comment, *The Role of Discounts in Determining Fair Value, Under Wisconsin's Dissenters' Rights Statutes: The Case for Discounts*, 1995 WIS. L. REV. 1155, 1160; *see, e.g.*, SHANNON P. PRATT ET AL., VALUING A BUSINESS: THE ANALYSIS AND APPRAISAL OF CLOSELY HELD COMPANIES 46 (3rd ed. 1996) (noting that "a minority interest discount reflects a value decrement due to lack of control" and observing that a minority discount is based on a lack of control); *id.* at 300-01 (observing that a minority discount is based on a lack of control). Stated differently, a minority discount signifies that "investors will pay less for [a minority stake] in a close corporation because of the inability to elect a sufficient number of directors to control management." Steven C. Bahls, *Resolving Shareholder Dissension: Selection of the Appropriate Equitable Remedy*, 15 J. CORP. L. 285, 301 (1990).

129. Shares of a close corporation, by definition, are not traded on a public market. As a result, it is considerably more difficult to sell close corporation stock than public corporation stock. Factors contributing to this difficulty include the greater time and expense associated with selling close corporation shares, as well as the smaller pool of potential buyers for such investments. *See* PRATT ET AL., *supra* note 128, at 334. The "marketability discount" is premised on a recognition of these factors and the accompanying reality that investors will usually pay less for close corporation shares because of the shares' relative illiquidity. *See, e.g.*, Pueblo Bancorporation v. Lindoe, Inc., 63 P.3d 353, 357 n.2 (Colo. 2003) ("A marketability discount adjusts the value of specific shares to reflect the fact that there is no ready trading market for the shares. Because

fair market value interpretation of fair value, therefore, minority and marketability discounts are appropriate.

The second approach to the meaning of fair value defines fair value simply as a pro rata share of the company's overall value. If a close corporation is valued at $10 million, for example, the fair value of a 25% minority ownership position in that company is worth 25% of the overall company value, or $2.5 million. Under this "enterprise value" approach, the value of shares in a close corporation is determined not by reference to what the particular shares would fetch in a hypothetical market sale, but instead by valuing the company as a whole and by ascribing to each share its pro rata portion of that overall enterprise value.[130] Further discounting for the shares' lack of control and lack of liquidity is inappropriate.[131]

Unfortunately, in the shareholder oppression context, there are no Texas cases addressing the meaning of fair value and the corresponding propriety of minority and marketability discounts. Outside of Texas, almost all courts that have considered the issue reject minority discounts in the oppression or other dissension-

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there are a small number of potential buyers of closely-held corporate stock, a shareholder may be unable to secure a willing buyer if he decides to cash out of his investment."); Advanced Communication Design, Inc. v. Follett, 615 N.W.2d 285, 291 (Minn. 2000) ("[S]hares in a closely held corporation cannot be sold as readily as shares in a corporation with securities traded over an exchange or in an established market and therefore investors tend to pay less, and sometimes significantly less, for such shares."); *Id.* ("A marketability discount 'adjusts for a lack of liquidity in one's interest in an entity', and should be distinguished from a minority discount, which adjusts for lack of control of the corporation." (quoting Balsamides v. Protameen Chems., Inc., 743 A.2d 721, 733 (N.J. 1999))).

130. As the Supreme Court of Colorado observed:

> One possible interpretation . . . is that fair value requires the court to value the dissenting shares by looking at what they represent: the ownership of a certain percentage of the corporation. In this case, the trial court found that Holding Company, as an entity, was worth $76.1 million. Lindoe owned 5.71 percent of Holding Company and therefore, under this view, Lindoe is entitled to 5.71 percent of Holding Company's value, or just over $4.3 million. Because the proper measure of value is the shareholder's proportionate interest in the value of the entity, discounts at the shareholder level are inapplicable.

Pueblo Bancorporation v. Lindoe, Inc., 63 P.3d 353, 360 (Colo. 2003).

131. *See supra* note 130. To distinguish these two positions on the meaning of fair value, a brief illustration is helpful. Assume that a close corporation is valued on a going concern basis at $10 million. Assume further that a court is valuing the shares of a 25% minority investor in a buyout proceeding. Under an enterprise value approach, a 25% ownership stake in a $10 million company would be valued on a pro rata basis at $2.5 million. Under a fair market value approach, however, a court would discount that $2.5 million amount to reflect (1) that a purchaser would pay less for a minority block of stock because it lacks control (the minority discount), and (2) that a purchaser would pay less for a block of close corporation stock because it cannot easily be sold (the marketability discount). If the combined effect of these discounts reduces the $2.5 million amount by 40%, the buyout price would decrease to $1.5 million. The valuation difference between the two approaches, in other words, is equivalent to the amount of the discounts.

related context.[132] Less agreement exists, however, on the propriety of the marketability discount.[133]

E. *Extension to the LLC*

In recent years, the LLC has emerged as the favored business structure for many closely held enterprises.[134] An LLC is a non-corporate business form that provides its owners, known as "members," with limited liability for the venture's obligations, favorable partnership tax treatment, and extensive freedom to contractually arrange the business.[135] Minority members of LLCs face many of the same risks and vulnerabilities as minority shareholders of close corporations, as the typical LLC is also characterized by the norm of majority rule and a lack of exit rights.[136] Nevertheless, in many jurisdictions, the issue of whether the oppression doctrine is applicable to the LLC setting is still an open question. In Texas, however, the question has been answered by statute. Article 8.12 of the Texas Limited Liability Company Act states that "Part Seven of the TBCA [the Texas Business Corporation Act] appl[ies] to a limited liability

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132. *See, e.g.*, Pooley v. Mankato Iron & Metal, Inc., 513 N.W.2d 834, 838 (Minn. Ct. App. 1994); *In re* Blake, 486 N.Y.S.2d 341, 349 (App. Div. 1985); Chiles v. Robertson, 767 P.2d 903, 926 (Or. Ct. App. 1989); Charland v. Country View Golf Club, Inc., 588 A.2d 609, 612 (R.I. 1991); *see also* Balsamides v. Protameen Chems., Inc., 734 A.2d 721, 734-35 (N.J. 1999) (listing cases). *But see* McCauley v. Tom McCauley & Son, Inc., 724 P.2d 232, 243-45 (N.M. Ct. App. 1986) (allowing a minority discount).

133. *Compare* Balsamides v. Protameen Chems., Inc., 734 A.2d 721, 733, 735-36, 738 (N.J. 1999) (applying a marketability discount to a buyout of the oppressor's shares by the oppressed investor), *and In re* Blake, 486 N.Y.S.2d 341, 349 (N.Y. App. Div. 1985) (rejecting a minority discount but stating the following: "A discount for lack of marketability is properly factored into the equation because the shares of a closely held corporation cannot be readily sold on a public market. Such a discount bears no relation to the fact that the petitioner=s shares in the corporation represent a minority interest."), *and* Munshower v. Kolbenheyer, 732 So.2d 385, 386 (Fla. Dist. Ct. App. 1999) (affirming a marketability discount and stating that "we rely on New York case law as persuasive in this matter"), *with* Chiles v. Robertson, 767 P.2d 903, 926 (Or. Ct. App. 1989) (rejecting a marketability discount), *and* Charland v. Country View Golf Club, Inc., 588 A.2d 609, 612-13 (R.I. 1991) (same).

134. *See, e.g.*, Larry E. Ribstein, *LLCs: Is the Future Here? A History and Prognosis*, 13 BUS. LAW TODAY 11, 13 (Nov./Dec. 2003) (observing that "LLCs are gradually replacing corporations and limited partnerships as the leading business entity").

135. *See, e.g.*, Moll, *supra* note 41, at 917-18; *see also* Elf Atochem N.A., Inc. v. Jaffari, 727 A.2d 286, 287 (Del. 1999) (stating that the Delaware LLC statute is designed "to permit persons or entities (members) to join together in an environment of private ordering to form and operate the enterprise under an LLC agreement with tax benefits akin to a partnership and limited liability akin to the corporate form").

136. *See, e.g.*, Moll, *supra* note 41, at 925-57 (arguing that LLC owners face many of the same risks as close corporation shareholders because LLCs are also characterized by a lack of exit rights, the norm of majority rule, the application of the business judgment rule, and a lack of advance planning).

company and its members, managers, and officers."[137] Part Seven of the Texas Business Corporation Act includes the receivership and liquidation provisions that give rise to the statutory cause of action for oppression.[138]

V. CONCLUSION

Although it has yet to receive the explicit blessing of the Texas Supreme Court, the shareholder oppression doctrine has a firm toehold in Texas jurisprudence. Unfortunately, the precise contours of the doctrine are fuzzy at best. What is clear, however, is that the doctrine's operation clashes with traditional employment at will, business judgment rule, and derivative lawsuit principles, and it may significantly alter how those principles are applied. Moreover, because a successful oppression claim provides the possibility of a buyout exit or other remedy, it is a particularly attractive doctrine for plaintiffs in close corporations or LLCs. For all of these reasons, Texas lawyers need to familiarize themselves with the shareholder oppression doctrine. Simply put, when disputes in Texas close corporations (or LLCs) are at issue, majority rule may no longer carry the day.

137. TEX. LTD. LIAB. CO. ACT art. 8.12(A) (Supp. 2008).

138. *See* TEX. BUS. CORP. ACT arts. 7.05, 7.06 (2003); TEX. BUS. ORGS. CODE §§ 11.404(a)(1)(C), 11.405 (2008); *supra* note 23 and accompanying text (discussing the receivership and liquidation provisions that give rise to the statutory cause of action for oppression). Article 8.12 of the LLC Act goes on to state that "[f]or purposes of the application of the articles of the TBCA . . ., as context requires: (1) a reference to a corporation includes a limited liability company; (2) a reference to a share includes a membership interest; (3) a reference to a shareholder includes a member; (4) a reference to a director includes a manager or, to the extent that the management of the limited liability company is reserved in whole or in part to the members, a member who manages the limited liability company . . . ."; TEX. LTD. LIAB. CO. ACT art. 8.12(C) (Supp. 2008); *see also* Pinnacle Data Servs., Inc. v. Gillen, 104 S.W.3d 188, 191-92, 196 (Tex. App.—Texarkana 2003, no pet.) (suggesting that the oppression doctrine applies in the LLC setting); *supra* notes 40-45 and accompanying text (discussing *Pinnacle*).