SHAREHOLDER OPPRESSION AND DISPUTES

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State Bar of Texas
39TH ANNUAL
ADVANCED CIVIL TRIAL COURSE
San Antonio July 13 - 15, 2016
Dallas August 17 - 19, 2016
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CHAPTER 7

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Member, American Law Institute (2007-Present).
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Texas Super Lawyer, *Texas Monthly* (2003-15), Top 50 Texas Female Lawyers (2004, 2005, 2008-15),
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Tarrant County Top Appellate Attorneys, *Fort Worth, Texas, Magazine* (2002-15, annually).
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Outstanding Subcommittee Chair, Appellate Practice Committee, ABA Section of Litigation (2009).
Best Series of Articles in Local Bar Publication Award, State Bar of Texas (2007).

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Southern Methodist University, J.D., with honors, May 1991.
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- J.D., Harvard Law School, 1991, *cum laude;* Senior Editor, *Journal of Law and Public Policy*
- B.B.A., Economics and Finance, Baylor University, 1988, *summa cum laude*

Bar Admissions

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Court Admissions

- United States Supreme Court
- Texas Supreme Court
- U.S. Court of Appeals for the Fifth Circuit
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- U.S. District Court for the Northern District of Texas

David Harper is a Haynes and Boone partner, trial lawyer and member of the firm's board of directors. David solves clients' complex business problems and implements their strategies both in the courtroom and the boardroom as a trusted business advisor. He has served as lead counsel for the most significant and complex disputes clients have--ranging from semiconductor fabrication patent and trade secret litigation to disputes about the sale of major businesses.

Teams that David has led or co-led have achieved remarkable success. For example, his team recently successfully defended a major semiconductor fabrication company in a patent infringement case in which the plaintiff conceded defeat in the trial court after a favorable Markman ruling. He successfully defended clients in a multi-week trial and then on appeal against claims of copyright infringement regarding video distribution rights. He also led a team that defeated claims in the trial court of alleged theft of software as trade secrets. Likewise in business disputes, he recently pursued claims for fraud against sellers of a business to a major work wear manufacturing company which was then mutually settled. David and the Haynes and Boone team he led won a multi-year battle defeating claims of alleged shareholder oppression in the Texas Supreme Court. And, he defended and resolved multiple lawsuits against the prominent founder of a major independent oil and gas company from claims about buyouts of other investors.

David's skills are sought out by boards seeking him as a member, including Baylor University, where he has served for several years as the chair of multiple committees. David has also served in significant leadership roles in the firm, including as the co-chair of the firm's overall litigation practice and on multiple firm management committees.

David has been recognized as a Best Lawyer in America, Woodward/White, Inc., (2014-2016); a Texas Super Lawyer, Thomson Reuters, (2003-2015); and is peer-review rated as AV Preeminent by *Martindale Hubbell® Law Directory*.

Selected Client Representations

Intellectual Property

- Successful defense in the trial court of Taiwan Semiconductor Manufacturing Company in patent litigation regarding lithography technology (*DSS v. TSMC, et al*, ____ WL ____ (EDTX).)

- U.S. District Court for the Eastern District of Texas
- U.S. District Court for the Southern District of Texas
- U.S. District Court for the Western District of Texas

- Successful defense of alleged theft of trade secret claims related to software (*Spear Marketing v. ARGO Data Resources*, 2013 WL 2149570 (N.D. Tex.).)
- Successful defense at trial of claims of copyright infringement, breach of license agreement and misappropriation of name brought by nationally syndicated radio show host against stage play production company and DVD distributor. &(*Baisden v. I'm Ready Productions*, 693 F.3d 491 (5th Cir. 2012).)

- Part of successful TSMC trial team winning claims of theft of semiconductor trade secrets as plaintiff against Chinese fab, SMIC.
- Successfully trying claims of breach of copyright license and distribution agreement for creator of Barney® children's television series.
- Trying and defeating claims of software copyright infringement brought by former employee against major car rental company (*Wood v. Cendant Corporation and Avis Holdings Group, Inc*., 2006 WL 2045839 (N.D. Okla.).)
- Securing summary judgment on claims that domain name registrar did not violate federal Anti-cybersquatting Consumer Protection Act of 1999 and Texas trademark anti-dilution statute (*Lockheed Martin v. Network Solutions, Inc.*, 141 F. Supp. 2d 648 (N.D. Tex. 2001)).

Complex Business Disputes

- Prosecution of fraud claims related to sale of business unit to major work wear manufacturer (settled)
- Successful defense of claims of shareholder oppression and breach of fiduciary duty at trial and appeal brought against privately held software company *(ARGO Date Resources v. Shagrithaya*, 380 S.W.3d 249 (Tex. App.—Dallas 2012, *pet. denied)).*
- Defending a trust against multi-million dollar claims of fraud, breach of fiduciary duty and conspiracy in a real estate transaction.
- Defending and resolving claims against founder of a major independent oil and gas company from multiple lawsuits about buyout transactions of investors.

Media, Libel and Invasion of Privacy

- Obtained summary judgment for financial publisher over alleged violations of federal and state securities laws. *Reynolds v. Murphy*, 188 S.W.3d 252 (Tex. App.—Fort Worth 2006) and *Reynolds v. Murphy (II)*, 266 S.W.3d 141 (Tex. App.—Fort Worth 2008).
- Multiple successful defenses of author of *Stolen Valor* in libel claims brought by individuals making false claims of military service and honors.

Professional Recognition

- Named in *The Best Lawyers in America*, Woodward/White, Inc., for Litigation - Intellectual Property, 2014-2016

- Named a Best Business Lawyer in Dallas for Business Litigation by *D Magazine*, D Magazine Partners, 2009
- Named in *Texas Super Lawyers*, Thomson Reuters, 2003-2015
- Named in Best Lawyers Under 40 by *D Magazine*, D Magazine Partners, 2002, 2004 and 2006
- *Martindale Hubbell® Law Directory* with a Peer Review Rating of AV® Preeminent™

P**rofessional and Community Activities**

- Deacon, Park Cities Baptist Church, including service as Chairman of Deacons and President of Trustees
- Board of Regents, Baylor University, including service as Chair, Academic and Student Affairs Committee
- President, Harvard Law School Association of Texas
- Co-Editor, Libel Defense Resource Center's Annual Survey of Privacy and Related Claims Against the Media
- Trustee, Trinity Christian Academy
- State Bar of Texas
- American Bar Association
- American Intellectual Property Law Association (AIPLA)
- Dallas Bar Association (Past Co-Chair, Media Relations Committee)
- Life Fellow, Texas Bar Foundation
- W.M. "Mac" Taylor, Jr. American Inn of Court (Master, 2008-Present)

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes

Other Authorities

SHAREHOLDER OPPRESSION AND DISPUTES

I. INTRODUCTION

The Supreme Court of Texas in 2014 refused to recognize a common-law cause of action for shareholder oppression and held nonreceiver equitable remedies were not available based on the rehabilitative receiver statute, partially because the court found other direct and derivative statutory and common-law tools and causes of action (generally) sufficient to protect a minority shareholder's interests (and the corporation).[1] *Ritchie* made clear that many claims belong to the corporation and thus stressed derivative proceedings as an available alternative to shareholder oppression claims (and lesser procedural hurdles for shareholders in closely held corporations). The following year the court liberally construed the definition of shareholder and recognized double derivative standing to bring derivative claims.[2] Thus, the court limited oppression claims but potentially broadened derivative claims. This paper outlines claims now used in shareholder disputes after *Ritchie* and *Sneed*.

II. DEFINITIONS.

The following are a few definitions used in the following sections:

Close corporation means a for-profit corporation that elects to be governed as a close corporation under subchapter O of the Business Organizations Code or a "domestic corporation formed under [subchapter O of the Business Organizations Code] or governed by [that] subchapter because of Section 21.705, 21.706, or 21.707."[3]

Close corporation provision means "a provision in the certificate of formation of a close corporation or in a shareholders' agreement of a close corporation."[4]

Closely held corporation means "a corporation with fewer than thirty-five shareholders" and "no shares listed on a national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national securities association."[5]

Domestic entity means "an organization formed under or the internal affairs of which are governed by [the Business Organizations Code]."[6]

Ordinary corporation means "a domestic corporation that is not a close corporation."[7]

Shareholder (or holder of shares) means (1) the person in whose name shares issued are registered in the share transfer records or (2) the beneficial owner of shares issued by a for-profit corporation, whose shares are held in a voting trust or by a nominee. For a derivative proceeding, shareholder "includes a beneficial owner whose shares are held in a voting trust or by a nominee on the beneficial owner's behalf."[8]

Shareholders' agreement means "a written agreement regulating an aspect of the business and affairs of or the relationship among the shareholders of a close corporation that has been executed under [subchapter O of the Business Organizations Code]."[9]

For an extensive list of definitions, see section 1.001 of the Business Organizations Code.

III. SHAREHOLDER DIRECT SUITS.

A. No Common-Law Claim for Shareholder Oppression or Statutory Right to Buyout Relief.

The court in Ritchie listed "various 'squeeze-out' or 'freeze-out' tactics sometimes alleged to deprive minority shareholders of benefits, to misappropriate those benefits for themselves, or to induce minority shareholders to relinquish their ownership for less than it is otherwise worth": "(1) denial of access to corporate books and records, (2) withholding payment of, or declining to declare, dividends, (3) termination of a minority shareholder's employment, (4) misapplication of corporate funds and diversion of corporate opportunities for personal purposes, and (5) manipulation of stock values."10

The court first held that the receiver statute supported only receiver relief, not lesser equitable remedies such as a stock buyout or dividend order.[11] Moreover, in deciding not to create a common-law cause of action for shareholder oppression, the court found adequate the statutory protection of the right to inspect books and the availability of a direct or derivative breach of fiduciary claim to remedy the other types of conduct. The court also noted other claims and remedies sought by shareholders. The court, however, did note that a "gap" remained in the protection of individual minority shareholders but chose not to impose a common-law duty on directors in closely held corporations "not to take oppressive

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

[2] *Sneed v. Webre*, 465 S.W.3d 169 (Tex. 2015).

[3] TEX. BUS. ORGS. CODE §§ 1.001(8), 21.701(1).

[4] *Id.* § 21.701(2).

[5] *Id.* § 21.563(a).

[6] *Id.* § 1.002(18).

[7] *Id.* § 21.703(3).

[8] *Id.* §§ 1.001(81), 21.551.

[9] *Id.* § 21.701(4).

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

[11] *Id.* at 877.

actions against an individual shareholder even if doing so is in the best interest of the corporation."[12] The court did so, in part, because of the lack of clarity in standards that would apply to any such duty. The court also reaffirmed that it does not recognize a formal fiduciary duty owed to individual shareholders and held that imposing a common-law duty not to act "oppressively" would be akin to such a duty.[13] Finally, the court noted that corporate relationships are, and should be, governed largely by contract and statute. The court expressed reluctance to allow courts to interfere with corporate governance and management or to interfere with private contracts by eliminating bargained for rights or by inserting rights not bargained for. Instead, the court decided that the legislature provided a "limited yet sufficient" receiver remedy for oppression of minority shareholders in a closely held corporation.[14]

The court included a caveat, "Although we do not foreclose the possibility that a proper case might justify our recognition of a new common-law cause of action to address a 'gap' in protection for minority shareholders, any such theory of liability will need to be based on a standard that is far more concrete than the meaning of 'oppressive.'"[15]

B. Accounting, Statutory Right to Examination of Books and Records.

Ritchie points out the statutory right to access books and records as protecting shareholders from the "denial of access to books" form of oppression. That is, the Business Organizations Code protects a shareholder's rights to examine corporate records and to be provided information. Section 3.153 of the Business Organizations Code provides: "each owner or member of a filing entity may examine the books and records of the filing entity maintained under section 3.151 and other books and records of the filing entity to the extent provided by the governing documents of the entity and the title of this code governing the filing entity."[16] Section 3.151 addresses accounts, minutes, owner addresses, and other books and records required by the Code.[17]

Upon written demand stating a proper purpose and subject to the governing documents, a shareholder (for at least six months or of at least 5% of the shares) may examine and copy, at a reasonable time, the corporation's relevant books, records of account, minutes, and share transfer records.[18] A proper purpose relates to the shareholder's individual interest or protection of the corporation's interest.[19] The request should specifically with detail list items for inspection and the proper purpose.

Section 21.222(b) contains certain defenses for withholding books, including improper use of prior examination and not in good faith or for a proper purpose.[20] The burden to plead and prove an improper purpose is on the resisting party.[21] A resisting party must plead specific facts to raise a fact issue on improper purpose.[22] If so, the resisting party is entitled to a jury trial on the issue if requested.[23] On written request, a shareholder may also receive copies of annual and interim statements.[24] The shareholder may also inspect the voting shareholder list. [25] Moreover, there are penalties for failures to prepare voting lists, notices of meeting, and refusal to examine books.[26] A court may order an inspection under section 21.222(a). The supreme court found these mechanisms sufficient to protect against one common complaint of oppression—inspection of the corporate books.[27]

Ritchie also notes the availability of an accounting.[28] An accounting serves a similar purpose as an inspection of books by systematically "recording

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[12] *Id.* at 889.

[13] *Id.* at 890.

[14] *Id.* at 891.

[15] *Id.* at 890.

[16] TEX. BUS. ORGS. CODE § 3.153.

[17] *Id.* § 3.151.

[18] *Id.* § 21.218(b).

[19] *See Biolustre Inc. v. Hair Ventures LLC*, No. 04-10-00360-CV, 2011 WL 540574, at *3 (Tex. App.—San Antonio Feb. 16, 2011, no pet.) (mem. op.) (affirming trial court's finding of proper purpose when corporation had not sent any financial information to shareholder for many years, including notice of a vote on a public offering, and plaintiff had substantial investment and interest in the corporation); *see also In re Dyer Custom Installation, Inc.*, 133 S.W.3d 878, 881 (Tex. App.—Dallas 2004, pet. denied) (listing grounds of improper purposes).

[20] TEX. BUS. ORGS. CODE § 21.222(b).

[21] *Chavco Investment Co., Inc. v. Pybus*, 613 S.W.2d 806, 810 (Tex. Civ. App.—Houston [14th Dist.] 1981, writ ref'd n.r.e.).

[22] *In re Dyer*, 133 S.W.3d at 881; *Chavco*, 613 S.W.2d at 809.

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

[24] TEX. BUS. ORGS. CODE § 21.219.

[25] *Id.* § 21.354, .372.

[26] *Id.* §§ 21.220-.222.

[27] *Ritchie*, 443 S.W.3d at 883; *see also Biolustre*, 2011 WL 540574, at *3 (ordering access to books and records).

[28] *Ritchie*, 443 S.W.3d at 882 (listing an accounting as a tool that Texas minority shareholders have asserted and that relies on the same actions that support oppression claims).

and summarizing business and financial transactions in books and analyzing, verifying and reporting the results."[29]

C. Breach of Contract.

Ritchie also noted that parties were free to protect their interests by contract. The court noted that shareholders may use a shareholder or other agreements to define shareholders' management and voting powers, to apportion profits and losses, to address the payment of dividends, to provide rights to buy or sell their shares from or to each other, the corporation or an outside party, and to set out employment terms.[30] The shareholder agreement may also include a mechanism to avoid or resolve disputes, including the use of consultants for key decisions or set out mediation or arbitration procedures. In many closely held (<35 shareholders) corporations, the parties often do not prepare agreements in advance—whether because it is a family business, the business started small and informally, or for any number of other reasons. A shareholder thus may have a breach of contract action against the contracting party.[31] Without a written contract, a party might assert an oral or implied contract.[32] Both theories may be difficult to prove. With or without an agreement, however, a shareholder may have other claims arising from shareholder disputes.

D. Breach of Fiduciary Duty/Duty to Disclose.

Ritchie recognized that in a few cases a shareholder might have an individual breach of fiduciary duty claim to protect shareholder complaints about, *e.g.*, dividends or compensation. But generally those decisions rest within the discretion of the corporation. The court emphasized the availability of derivative actions (with lesser procedural hurdles for closely held corporations) for some shareholder complaints.

The *Ritchie* court noted that a contract may obligate an officer or director to conduct the corporation's business in a manner that suits a shareholder's interests.[33] But generally an informal fiduciary-like relationship may arise only from moral, social, domestic, or a personal relationship of trust and confidence. No such duty arises in a business transaction unless it existed prior to and separate from the transaction at issue.[34] On remand, the court of appeals found no evidence of an informal fiduciary duty in *Ritchie*.[35]

The supreme court noted in *Ritchie* that it had never applied the business judgment rule to informal fiduciary duties,[36] and although not reaching the issue, it noted that "because such duties arise separate and apart from business relationships, we see no reason to assume that the rule would apply."[37] Moreover, the court reaffirmed that it has "never recognized a formal fiduciary duty between majority and minority shareholders in a closely-held corporation."[38] Instead, the court recognizes "a fiduciary duty owed by corporate officers and directors to the corporation, which prohibits officer [sic] and directors from usurping corporate opportunities for personal gain and requires them to exercise their 'uncorrupted business judgment for the sole benefit of the corporation.'"[39]

One of the fiduciary duties often imposed is one of full and fair disclosure of all important

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[29] *Lewis v. Xium Corp.*, No. 07-08-0219-CV, 2009 WL 1953419, at *7 (Tex. App.—Amarillo July 8, 2009, pet. denied) (mem. op.) (citing *New Jersey Bank (N.A.) v. Knuckley*, 637 S.W.2d 920, 921 (Tex. 1982)).

[30] TEX. BUS. ORGS. CODE §§ 21.052-.059, 21.101-.110, 21.210, 21.401-.408.

[31] *Tex. Ear Nose & Throat Consultants, PLLC v. Jones*, 470 S.W.3d 67, 76-78 (Tex. App.—Houston [14th Dist.] 2015, no pet.) (upholding breach of employment agreement finding).

[32] For an extensive discussion of contract law, *see* Richard R. Orsinger, *170 Years of Contract Law*, The History of Texas Supreme Court Jurisprudence (State Bar of Texas, April 2013).

[33] *Ritchie*, 443 S.W.3d at 888-89.

[34] *Id.* at 874 n.27 (citing *Meyer v. Cathey*, 167 S.W.3d 327, 330-31 (Tex. 2005)), 888-89 n.58 (citing *Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171, 176-77 (Tex. 1997)); *see also Cardiac Perfusion Servs. v. Hughes*, 436 S.W.3d 790, 791 (Tex. 2014); *Aubrey v. Barlin*, No. 1:10-CV-00076-DAE, 2016 WL 393551, at *7 (W.D. Tex. Feb. 1, 2016); *Power Reps., Inc. v. Cates*, No. 01-13-00856, 2015 WL 4747215, at *10-12 (Tex. App.—Houston [1st Dist.] Aug. 11, 2015, no pet.) (memo op.).

[35] *Ritchie v. Rupe*, No. 05-08-00615-CV, 2016 WL 145581, at *4-6 (Tex. App.—Dallas Jan. 12, 2016) (memo op. on remand); *see also Power Reps., Inc. v. Cates*, No. 01-13-00856-CV, 2016 WL 474215, at *10-12; *N. Tex. Opportunity Fund L.P. v. Hammerman & Gainer Int'l, Inc.*, 107 F. Supp. 3d 620, 636-37 (N.D. Tex. 2015).

[36] "The business judgment rule in Texas generally protects corporate officers and directors, who owe fiduciary duties to the corporation, from liability for acts that are within the honest exercise of their business judgment and discretion." *Sneed*, 465 S.W.3d at 173 (citing *Cates v. Sparkman*, 11 S.W. 846, 848–49 (1889)).

[37] *Ritchie*, 443 S.W.3d at 874 n.27.

[38] *Id.* (citing *Willis v. Donnelly*, 199 S.W.3d 262, 276–77 (Tex. 2006)).

[39] *Id.* (citing *Int'l Bankers Life Ins. v. Holloway*, 368 S.W.2d 567, 576-77 (Tex. 1963)).

information.[40] Some courts might impose a duty to disclose even when no confidential or fiduciary relationship exists. Those courts hold that "[a] duty to disclose may arise (1) when the parties have a confidential or fiduciary relationship; (2) when one party voluntarily discloses information, which gives rise to the duty to disclose the whole truth; (3) when one party makes a representation, which gives rise to the duty to disclose new information that the party is aware makes the earlier representation misleading or untrue; or (4) when one party makes a partial disclosure and conveys a false impression, which gives rise to a duty to speak."[41] The Texas Supreme Court has not yet decided the scope of the duty to disclose. Nor has the court adopted the broad commercial duty set out in section 551 of the Restatement (Second) of Torts from which the last three contexts derive.[42]

Finally, because the court of appeals recognized a shareholder oppression action, the court of appeals in *Ritchie* determined the appropriate measure of damage for the valuation of stock—a ruling not appealed. The discussion related to enterprise and fair market value may be useful for other claims. The court held as follows:

> Two types of "fair value" are enterprise value and fair market value. The enterprise value of stock is determined by the value of the company as a whole and ascribing to each share its pro rata portion of that overall enterprise value. Enterprise value does not include a discount based on the stock's minority status or lack of marketability. In contrast, "fair market value" of corporate stock has been defined as "the price at which the stock would change hands between a willing seller, under no compulsion to sell, and a willing buyer, under no compulsion to buy, with both parties having reasonable knowledge of relevant facts."
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> ….
>
> Enterprise value has been seen as the appropriate valuation when a minority shareholder, with no desire to leave the corporation, has been forced to relinquish his ownership position by the oppressive conduct of the majority. In that situation, "[t]he oppressed minority investor was not looking to sell, and the oppressive majority investor, absent the threat of dissolution or other judicial sanction, was not looking to buy." Likewise, enterprise value has been held to be the appropriate value for a shareholder dissenting to a merger: in that situation there is a willing buyer, but not a willing seller.[43]

Thus, to the extent a buyout is an available remedy for this or other claims, *Ritchie* is instructive on the measure of damage. Moreover, a court might also be willing to grant equitable relief based on a breach of fiduciary duty claim.

E. Common-law Fraud, Statutory Fraud, Constructive Fraud, Fraudulent Transfer.

Ritchie notes that shareholders often bring fraud claims based on the allegedly oppressive conduct. The court also noted that if the controlling directors or shareholders act fraudulently to manipulate the value of corporate stock shares, common law and statutory remedies may be available.[44] Other conduct may also underlie a fraud claim.[45] Moreover, a shareholder might base a fraud claim on a nondisclosure if a duty to disclose can be established. Shareholders might face proof problems with fraud claims. A fraud claim requires a showing of (1) a material misrepresentation, (2) made with knowledge of its falsity or recklessly, (3) made with the intention it be acted on, and (4) the other party relies on it and thereby suffers injury.[46] If the promise relates to future performance (*e.g.*,

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[40] *Johnson v. Peckham*, 120 S.W.2d 509, 512-14 (Tex. 1942).

[41] *White v. Zhou Pei*, 452 S.W.3d 527, 537-38 (Tex. App.—Houston [14th Dist.] 2014) (involving shareholder suit against corporate officer/shareholder in closely held corporation); *see also* Comm. on Pattern Jury Charges, State Bar of Tex., *Texas Pattern Jury Charges: Business, Consumer, Insurance & Employment* PJC 105.4 (citing cases adopting four-part duty to disclose); *Solutioners Consulting Ltd v. Gulf Greyhound Partners, Ltd.*, 237 S.W.3d 379, 385 (Tex. App.—Houston [14th Dist.] 2007, no pet.) (listing four bases for duty to disclose).

[42] *See Bradford v. Vento*, 48 S.W.3d 749, 755 (Tex. 2001); *SmithKline Beecham Corp. v. Doe*, 903 S.W.2d 347, 352 (Tex. 1995).

[43] *Ritchie v. Rupe*, 339 S.W.3d 275, 300-01 (Tex. App.—Dallas 2011), *rev'd*, 443 S.W.3d 856 (Tex. 2014).

[44] S*ee, e.g., In re Mandel*, 578 Fed. Appx. 376 (5th Cir. 2014) (affirming fraud finding based on misrepresentations to shareholder that precluded shareholder from developing technology).

[45] *Ritchie*, 443 S.W.3d at 888 n.56 (citing TEX. REV. CIV. STAT. art. 581-32-33-1 (Texas Securities Act); TEX. BUS. & COM. CODE § 27.01 (fraud in real estate and stock transactions); *Allen v. Devon Energy Holdings, L.L.C.*, 367 S.W.3d 355, 369 (Tex. App.—Houston [1st Dist.] 2012, judgm't set aside by agr.) (addressing fraud claims relating to closely held company's purchase of minority shareholders' shares)).

[46] *See, e.g., Johnson v. Brewer & Pritchard, P.C.*, 73 S.W.3d 193, 211 n.45 (Tex. 2002).

dividend payments), a shareholder will need to prove that the promise was made without intent to perform at the time made.[47] A shareholder may also have problems establishing that his reasonable reliance caused his alleged loss.[48] Nevertheless, common-law fraud claims appear frequently in shareholder dispute cases.

F. Unjust Enrichment, Quantum Meruit, Money Had and Received.

Ritchie also noted that shareholders had brought claims for unjust enrichment and quantum meruit based on the same facts as the oppression claim. Thus, a shareholder may sometimes seek equitable restitution-based remedies in shareholder disputes.[49] Again, the claim for unjust enrichment or money had and received may belong to the corporation.

"A party may recover under the unjust enrichment theory when one person has obtained a benefit from another by fraud, duress, or the taking of an undue advantage."[50] As noted above, fraud frequently appears in shareholder disputes. Duress or undue advantage may be more difficult to establish in the context of investing, participating in, or working at a corporation. "An action for money had and received arises when the defendant obtains money which in equity and good conscience belongs to the plaintiff. This action is not premised on wrongdoing, but looks only to the justice of the case and inquires whether the defendant has received money which rightfully belongs to another. A cause of action for money had and received belongs conceptually to the doctrine of unjust enrichment."[51]

Quantum meruit is an equitable remedy which does not arise out of a contract but is independent of it. Generally, a party may recover under quantum meruit only when there is no express contract covering the services or materials furnished. This remedy "is based upon the promise implied by law to pay for beneficial services rendered and knowingly accepted." Recovery in quantum meruit will be had when nonpayment for the services rendered could "result in an unjust enrichment to the party benefited by the work." To recover under quantum meruit a claimant must prove that:

1) valuable services were rendered or materials furnished;
2) for the person sought to be charged;
3) which services and materials were accepted by the person sought to be charged, used and enjoyed by him;
4) under such circumstances as reasonably notified the person sought to be charged that the plaintiff in performing such services was expecting to be paid by the person sought to be charged.[52]

Given that services rendered are required, a shareholder's employment or consulting for the corporation might give rise to a quantum meruit claim when there is no contract but the shareholder claims non- or underpayment.

G. Conversion, Texas Theft Liability Act.

Conversion is another claim *Ritchie* identifies as being brought by shareholders based on "oppressive" acts. Some shareholders also pursue Texas Theft Liability Act claims.[53]

Conversion is the unauthorized and wrongful assumption and exercise of control over the personal property of another, to the exclusion of the owner's rights.[54] "A claim for conversion requires a plaintiff to show that (1) he owned, had legal possession of, or was entitled to possession of the property; (2) the defendant assumed and exercised dominion and control over the property in an unlawful and unauthorized manner, to the exclusion of and inconsistent with the plaintiff's rights; and (3) the defendant refused the plaintiff's demand for return of the property."[55] "An action will lie for conversion of money when identification of the money is possible and there is a breach of an obligation to deliver the specific money in

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[47] *Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 48 (Tex. 1998).

[48] *ARGO Data Resources v. Shagrithaya*, 380 S.W.3d 249, 273 (Tex. App.—Dallas 2012, pet. denied).

[49] *See Burrow v. Arce*, 997 S.W.2d 229, 237 (Tex. 1999) (discussing disgorgement); *Heldenfels Bros., Inc. v. Corpus Christi*, 832 S.W.2d 39, 41 (Tex. 1992) (discussing unjust enrichment); *Vortt Expl. Co. v. Chevron U.S.A., Inc.*, 787 S.W.2d 942, 944 (Tex. 1990) (discussing quantum meruit); *Amoco Prod. Co. v. Smith*, 946 S.W.2d 162, 164 (Tex. App.—El Paso 1997, no writ) (discussing money had and received).

[50] *Heldenfels*, 832 S.W.2d at 41.

[51] *Amoco*, 946 S.W.2d at 164 (citations omitted).

[52] *Vortt Expl. Co.*, 787 S.W.2d at 944 (citations omitted).

[53] *See* TEX. CIV. PRAC. & REM. CODE §§ 134.001-.005 (Texas Theft Liability Act); *N. Tex. Opportunity Fund L.P. v. Hammerman & Gainer Int'l, Inc.*, 107 F. Supp. 3d 620, 637-38 (N.D. Tex. 2015) (reviewing pleading of claims for conversion, money had and received, and TTLA by former shareholder); *see also Waisath v. Lack's Stores, Inc.*, 474 S.W.2d 444, 447 (Tex. 1971) (discussing conversion); *Khorshid, Inc. v. Christian*, 257 S.W.3d 748, 758-59 (Tex. App.—Dallas 2008, no pet.) (same).

[54] *Automek, Inc. v. Orandy*, 105 S.W.3d. 60, 63 (Tex. App.—Houston [1st Dist.] 2003, no pet.).

[55] *Id.*

question or to otherwise treat specific money. When a person has designated a particular use for proceeds from a check, those proceeds count as 'specific money' capable of identification."[56] The claim may belong to the corporation, depending on the facts, and if money is involved, a shareholder may have trouble identifying "specific money."

Under the Texas Theft Liability Act "[a] person who commits theft is liable for the damages resulting from the theft."[57] Theft "means unlawfully appropriating property or unlawfully obtaining services as described by [sections 31.03-.07 or 31.11-.14 of the Texas] Penal Code."[58] Again, the claim may belong to the corporation, and a shareholder may have difficulty proving "theft" by criminal conduct.

H. Statutory Receivers.

"A receiver may be appointed for a domestic entity or for a domestic entity's property or business only as provided for and on the conditions" in the Business Organizations Code.[59] An owner or member may seek a rehabilitative receiver and a party with interest in property may seek a receiver for that property. Because receivers in general are harsh, courts generally strictly construe and enforce the statutory requirements.[60]

1. Rehabilitative Receiver.

The statutory receiver provisions apply to all corporations (or domestic entities). The statute lists five grounds along with several other requirements to appoint a rehabilitative receiver:

> (a) Subject to Subsection (b), a court that has jurisdiction over the property and business of a domestic entity under Section 11.402(b) may appoint a receiver for the entity's property and business if:
>
> (1) in an action by an owner or member of the domestic entity, it is established that:
>
> (A) the entity is insolvent or in **imminent danger of insolvency**;
> (B) the **governing persons of the entity are deadlocked** in the management of the entity's affairs, the owners or members of the entity are unable to break the deadlock, and irreparable injury to the entity is being suffered or is threatened because of the deadlock;
> (C) the actions of the governing persons of the entity are **illegal, oppressive, or fraudulent**;
> (D) the **property of the entity is being misapplied or wasted**; or
> (E) with respect to a for-profit corporation, the shareholders of the entity are deadlocked in voting power and have failed, for a period of at least two years, to elect successors to the governing persons of the entity whose terms have expired or would have expired on the election and qualification of their successors;
>
> (2) in an action by a creditor of the domestic entity, it is established that:
>
> (A) the entity is insolvent, the claim of the creditor has been reduced to judgment, and an execution on the judgment was returned unsatisfied; or
> (B) the entity is insolvent and has admitted in writing that the claim of the creditor is due and owing; or
>
> (3) in an action other than an action described by Subdivision (1) or (2), courts of equity have traditionally appointed a receiver.
>
> (b) A court may appoint a receiver under Subsection (a) *only if*:

[56] *S.W. Indus. Inv. Co., Inc. v. Berkeley House Investors*, 695 S.W.2d 615, 617 (Tex. App.—Dallas 1985, writ ref'd n.r.e) (citations omitted).

[57] TEX. CIV. PRAC. & REM. CODE § 134.003.

[58] *Id.* § 134.002.

[59] TEX. BUS. ORGS. CODE § 11.401.

[60] *See, e.g. Mueller v. Beamalloy, Inc.*, 994 S.W.2d 855 (Tex. App.—Houston [1st Dist.] 1999, no pet.).

(1) circumstances exist that are considered by the court **to necessitate the appointment of a receiver to conserve the property and business of the domestic entity and avoid damage to interested parties**;
(2) **all other requirements of law** are complied with; and
(3) the court determines that **all other available legal and equitable remedies,** including the appointment of a receiver for specific property of the domestic entity under Section 11.402(a), **are inadequate**.

(c) *If the condition necessitating the appointment of a receiver under this section is remedied, the receivership shall be terminated immediately*, the management of the domestic entity shall be restored to its managerial officials, and the receiver shall redeliver to the domestic entity all of its property remaining in receivership.[61]

Fraudulent and illegal actions must pose a danger to the corporation.[62] The supreme court explained "oppression" in *Ritchie*. Oppressive actions occur when a corporation's directors or managers "abuse their authority over the corporation with the intent to harm the interests of one or more of the shareholders, in a manner that does not comport with the honest exercise of their business judgment, and by doing so create a serious risk of harm to the corporation."[63] For example, if a director improperly terminates a minority shareholder's employment "for no legitimate purpose, intended to benefit the directors or individual business shareholders at the expense of the minority shareholder, and harmful to the corporation," that conduct might constitute oppression that supports a rehabilitative receiver.[64]

Ritchie rejected prior intermediate court rulings that presumed a common-law cause of action for oppression existed or had adopted other equitable remedies (such as a buyout of shares) based on the statute. [65] The court held the receiver was the only remedy authorized by the statute.[66] Parties should draft or amend petitions and complaints to allege causes of action and remedies noted as available by the *Ritchie* court.[67]

The court noted that it need not decide "whether a trial court could properly appoint a rehabilitative receiver and authorize or order the receiver to implement a buyout of a shareholder's interests."[68] But the court further noted "An order authorizing or requiring a receiver to buy out a shareholder's interests would be authorized and proper under the statute only if the buyout would both avoid damage to an interested party and conserve the property and business of the domestic entity. If the buyout would help the shareholder but hurt the corporation an order authorizing the receiver to effectuate the buyout would likely not comply with the statute authorizing the appointment."[69]

A court may construe an order as an order appointing a rehabilitative receiver (or over specific property) even if given another name. For example, in one case, the trial court appointed a "master" for discovery and to receive income and pay obligations.[70] Considering that order to be a receiver order, the court found it improper when the record had no evidence to support the findings necessary to appoint a receiver (*e.g.*, imminent harm and no lesser remedy available).[71] The burden to demonstrate the factors rests with the moving party.[72]

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[61] TEX. BUS. ORGS. CODE § 11.404 (emphasis added) (formerly TEX. BUS. CORP. ACT art. 7.05); *Spiritas v. Davidoff*, 459 S.W.3d 224, 236 (Tex. App.—Dallas 2015, no pet.) (requiring evidence of irreparable injury).

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

[63] *Id.*

[64] *Id.* at 886.

[65] *Id.* at 872-73, 877; *see also Cardiac Perfusion Servs. v. Hughes*, 436 S.W.3d 790, 791 (Tex. 2014) (holding buyout remedy not available under common-law claim for oppression or under current receivership statute); *In re Mandel*, 578 Fed. Appx. 376 (5th Cir. 2014) (recognizing rehabilitative receiver only statutory remedy for shareholder oppression).

[66] A house bill filed in the 2015 legislative session would have added a section to the Business Organizations Code that authorized additional remedies; that bill was left pending in committee.

[67] *Natale v. Espy Corp.*, No. 13-30008-MGM, 2015 WL 3632227 (D. Mass. June 2, 2015) (ruling on motion to amend to add new causes of action).

[68] *Ritchie*, 443 S.W.3d at 877 n.32.

[69] *Id.* (quotations omitted).

[70] *Chapa v. Chapa*, No. 04-12-00519-CV, 2012 WL 6728242 (Tex. App.—San Antonio Dec. 28, 2012, no pet.) (memo op.).

[71] *Id.* at *6.

[72] *XR-5 v. Margolis*, No. 02-10-00290-CV, 2011 WL 1103794, at *2 (Tex. App.—Fort Worth March 24, 2011, no pet.) (memo op.).

2. Receiver for Specific Property.

The Code allows appointment of a receiver over specific property as follows:

> (a) Subject to Subsection (b), and on the application of a person whose right to or interest in any property or fund or the proceeds from the property or fund is probable, a court that has jurisdiction over specific property of a domestic or foreign entity may appoint a receiver in an action:
>
> (1) by a vendor to vacate a fraudulent purchase of the property;
> (2) by a creditor to subject the property or fund to the creditor's claim;
> (3) between partners or others jointly owning or interested in the property or fund;
> (4) by a mortgagee of the property for the foreclosure of the mortgage and sale of the property, when:
>
> (A) it appears that the mortgaged property is in danger of being lost, removed, or materially injured; or
> (B) it appears that the mortgage is in default and that the property is probably insufficient to discharge the mortgage debt; or
>
> (5) in which receivers for specific property have been previously appointed by courts of equity.
>
> (b) A court may appoint a receiver for the property or fund under Subsection (a) only if:
>
> (1) with respect to an action brought under Subsection (a)(1), (2), or (3), it is shown that the property or fund is in danger of being lost, removed, or materially injured;
> (2) circumstances exist that are considered by the court to necessitate the appointment of a receiver to conserve the property or fund and avoid damage to interested parties;
> (3) all other requirements of law are complied with; and
> (4) the court determines that other available legal and equitable remedies are inadequate.
>
> (c) The court appointing a receiver under this section has and shall retain exclusive jurisdiction over the specific property placed in receivership. The court shall determine the rights of the parties in the property or its proceeds.
> (d) If the condition necessitating the appointment of a receiver under this section is remedied, the receivership shall be terminated immediately, and the receiver shall redeliver to the domestic entity all of the property remaining in receivership. [73]

A court that has subject matter jurisdiction over specific property of an entity that is located in the state and is involved in litigation has jurisdiction to appoint a receiver for that property.[74] The court appointing a receiver has exclusive jurisdiction over the specific property placed in receivership.[75] If the entity files for bankruptcy, however, any claims to the business and assets in the possession, custody, and control of the receiver will automatically be stayed, and the court cannot dispose of any of these claims.[76]

I. Other Claims.

Depending on the facts presented, a shareholder may pursue other claims against corporate directors, officers, or employees.

For example, in one case, shareholders accused board members and officers who conspired to form a different company to which confidential information and core technology would be transferred. The plaintiff shareholders brought Lanham Act, RICO, breach of fiduciary duty, aiding and abetting, conversion, and conspiracy claims.[77]

In another case, myriad claims and counterclaims were filed in a shareholder dispute: breach of fiduciary duty, fraud, conversion, conspiracy, DTPA,

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[73] TEX. BUS. ORGS. CODE § 11.403 (formerly TEX. BUS. CORP. ACT art. 7.04); *Spiritas*, 459 S.W.3d at 236-37 (requiring evidence of irreparable damage).

[74] TEX. BUS. ORGS. CODE § 11.402.

[75] *Id.* § 11.403(C).

[76] *See Saden v. Smith*, 415 S.W.3d 450, 471 (Tex. App.—Houston [1st Dist.] 2013) (affirming final judgment deferring determination of the assets held by the receiver to the bankruptcy court).

[77] *Lowe v. Eltan*, No. 9:05-CV-28, 2015 WL 1385553, at *2-3 (E.D. Tex. March 2, 2015).

shareholder oppression, conversion, Texas Theft Liability Act, tortious interference with prospective and existing contractions, and other equitable relief.[78]

By way of further example, another shareholder dispute involved claims of breach of contract, tortious interference, and fraud.[79]

IV. SHAREHOLDER DERIVATIVE SUITS.

A shareholder of a corporation can bring a claim derivatively on behalf of the corporation if the corporation's directors have harmed the corporation. Historically, as set out in *Cates v. Sparkman*,[80] there were three elements of a derivative suit brought on behalf of any corporation. First, the demand requirement—"[t]he company must refuse to sue."[81] Second, "[t]here must be a breach of duty."[82] This breach must amount to "*ultra vires*, fraudulent and injurious practices, abuse of power, [or] oppression on the part of the company …."[83] Third, "[t]here must be injury to the [share]holder."[84] In 1997, the Texas Legislature revised the Texas Business Corporation Act ("TBCA"), including the statutory provisions that govern shareholder derivative suits.[85] This revision superseded the common-law of derivative suits set forth in *Cates*, which is now set out in the Texas Business Organizations Code.[86] *Ritchie*, however, quoted *Cates* for several propositions.

A. Business Judgment Rule.

The "business judgment rule protects corporate officers and directors from being held liable to the corporation for alleged breach of duties based on actions that are negligent, unwise, inexpedient, or imprudent if the actions were 'within the exercise of their discretion and judgment in the development or prosecution of the enterprise in which their interests are involved.' 'Directors, or those acting as directors, owe a fiduciary duty to the corporation in their directorial actions, and this duty includes the dedication of their uncorrupted business judgment for the sole benefit of the corporation.' The business judgment rule also applies to protect the board of directors' decision to pursue or forgo corporate causes of action.

Thus, the business judgment rule traditionally is implicated twice within the life cycle of a shareholder derivative proceeding brought on behalf of a corporation. First, the business judgment rule applies to the board of directors' decision whether to pursue the corporation's cause of action. Second, the business judgment rule applies as a defense to the merits of a shareholder's derivative lawsuit that asserts claims against the corporation's officers or directors for breach of duties that result in injury to the corporation."[87]

"[C]ourts will not interfere with the officers or directors in control of the corporation's affairs based on allegations of mere mismanagement, neglect, or abuse of discretion. In contrast, an officer or director's breach of duty that would authorize court interference 'is that which is characterized by ultra vires, fraudulent, and injurious practices, abuse of power, and oppression on the part of the company or its controlling agency clearly subversive of the rights of the minority, or of a shareholder, and which, without such interference, would leave the latter remediless.'"[88] Mismanagement-type allegations may face special exceptions or motions for summary judgment.

"*Ritchie* affirms that the business judgment rule applies to closely held corporations. The Legislature's codification of shareholder derivative proceeding procedures in article 5.14 [of the TBCA] did not alter how the business judgment rule, as announced in *Cates*, applies to the merits of claims against a corporation's officers or directors for breach of corporate duties. The business judgment rule continues to apply to the merits of a derivative proceeding, whether brought on behalf of a closely held corporation or any other corporation, when a corporation's officers' or directors' actions are being challenged."[89]

Moreover, the business judgment rule as applied to the decision to file suit is codified in the Business Organizations Code (and formerly the Business Corporation Act) and applies to derivative suits not brought on behalf of closely held corporations. That is, if an affirmative majority vote "determines, in good faith, after conducting a reasonable inquiry and based

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[78] *Power Reps., Inc. v. Cates*, No. 01-13-00856, 2015 WL 4747215, at *10-12 (Tex. App.—Houston [1st Dist.] Aug. 11, 2015, no pet.) (memo op.)

[79] *White*, 452 S.W.3d at 536.

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

[81] *Id.* at 849.

[82] *Id.*

[83] *Id.*

[84] *Id.*

[85] Bryan Stanfield, *For Better or for Worse?: Marriage of the Texas and Model Business Corporation Acts' Derivative Action Statutes and What it Means for Corporations*, 35 TEX. TECH L. REV. 347, 351–52 (2004).

[86] *Sneed v. Webre*, 465 S.W.3d 169 (Tex. 2015).

[87] *Id.* at 178-79 (citing *Cates*, 11 S.W. at 849, and *Ritchie*, 443 S.W.3d at 868) (omitting other citations and quotations).

[88] *Id.* at 186.

[89] *Id.* at 179.

on factors the person or group considers appropriate under the circumstances, that continuation of the derivative proceeding is not in the best interests of the corporation," the court "shall" dismiss the derivative proceeding on motion of the corporation.[90] The legislature thus gave the directors of most corporations "the ability to exercise their business judgment in deciding whether to pursue the corporation's causes of action."[91] The business judgment rule, however, does not protect a closely held corporation's board of directors' decision not to pursue a corporate cause of action and a shareholder plaintiff need not plead and prove that such a decision was tainted by fraud, self-interest, or other wrongdoing to establish derivative standing.[92]

B. Standing.

1. Statutory Standing to Bring Derivative Suit.

Section 21.552 provides that "[a] shareholder may not institute or maintain a derivative proceeding unless:

> (1) the shareholder:
>
> > (A) was a shareholder of the corporation at the time of the act or omission complained of; or
> > (B) became a shareholder by operation of law from a person that was a shareholder at the time of the act or omission complained of; and
>
> (2) the shareholder fairly and adequately represents the interests of the corporation in enforcing the right of the corporation."[93]

Standing is a component of subject matter jurisdiction. Thus, the derivative suit of a party who does not meet those requirements is subject to dismissal.[94]

2. Closely Held Corporations: No Standing Requirement and Double-Derivative "Standing."

The standing requirements in section 21.552 do not apply to closely held corporations. And a shareholder need not overcome the "business judgment to bring suit" provisions to show standing.[95] Thus, a shareholder in a closely held corporation need not show that it adequately represents the interests of the corporation."[96] But the party bringing the suit must be a "shareholder" under section 21.551; shareholder "includes a beneficial owner whose shares are held in trust or by a nominee on the beneficial owner's behalf."[97]

In *Sneed*, the plaintiff bringing the derivative suit was a shareholder in the sole shareholder parent company of the subsidiary on whose behalf he brought the derivative suit. The court had to decide whether this twice-removed or "double derivative" status gave him standing as a shareholder to bring the derivative action. The court reasoned that the language defining a shareholder as "including" a beneficial owner was not the language of an exclusive list.[98] And it drew from other case law that has likened beneficial ownership to equitable ownership, noting stockholders are the beneficial or equitable owners of the assets of the corporation.[99] The court concluded that a shareholder of a parent company is an equitable owner of the parent company's wholly owned subsidiary. Therefore, such a shareholder has double derivative standing to bring suit on behalf of the parent and the subsidiary.[100] Otherwise, the mere additional corporate layer would insulate wrongs and wrongdoers from judicial intervention.[101]

C. Demand and Suit.

1. Ordinary For-Profit Corporations: Demand and Recovery for the Corporation.

The Business Organizations Code includes demand requirements to institute a derivative proceeding:

> (a) A shareholder may not institute a derivative proceeding until the 91st day after the date a written demand is filed with the corporation stating with particularity the act, omission, or other matter that is the subject of the claim or challenge and requesting that the corporation take suitable action.

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[90] TEX. BUS. ORGS. CODE § 21.558.

[91] *Sneed*, 465 S.W.3d at 181.

[92] TEX. BUS. ORGS. CODE § 21.563(b) (section 21.558 does not apply to closely held corporations); *Sneed*, 465 S.W.3d at 181.

[93] TEX. BUS. ORGS. CODE § 21.552; *Sneed*, 465 S.W.3d at 181.

[94] *Tran v. Hoang*, 481 S.W.3d. 313, 316 (Tex. App.—Houston [1st Dist.] 2015, pet. denied) ("Standing can be raised in a traditional motion for summary judgment.").

[95] *Sneed*, 465 S.W.3d at 189.

[96] *Id.* at 183; *see also* TEX. BUS. ORGS. CODE § 21.552 (formerly TEX. BUS. CORP. ACT art. 5.14(B)(1)).

[97] TEX. BUS. ORGS. CODE § 21.551.

[98] *Sneed*, 465 S.W.3d at 190.

[99] *Id.* at 190-92.

[100] *Id.* at 193.

[101] *Id.* at 192.

(b) The waiting period required by Subsection (a) before a derivative proceeding may be instituted is not required if:

(1) the shareholder has been previously notified that the demand has been rejected by the corporation;
(2) the corporation is suffering irreparable injury; or
(3) irreparable injury to the corporation would result by waiting for the expiration of the 90-day period.[102]

A demand that does not state "with particularity the act, omission, or other matter that is the subject of the claim or challenge and requesting that the corporation take suitable action" is insufficient to maintain the suit.[103] Moreover, the demand may not be made anonymously but must instead name the shareholder.[104] The Code no longer contains a "demand futility" excuse.[105] The derivative recovery is for the corporation.[106]

2. Closely Held Corporations: No Demand and May Treat as Individual Recovery.

Shareholders in a closely held corporation need not make a demand upon the corporation before filing a derivative suit.[107] That is because the standing, demand, and dismissal provisions do not apply to a closely held corporation.[108] Given that the "business judgment to pursue suit" provisions do not apply to closely held corporations, it makes sense that the demand requirement likewise does not apply. The demand requirement affords the directors an opportunity to exercise that business judgment.[109] Moreover, when justice requires, a court may treat a derivative action on behalf of the corporation "as a direct action brought by the shareholder for the shareholder's own benefit."[110] Thus, while the supreme court did not recognize a common-law shareholder oppression claim, the court recognized in *Ritchie* and *Sneed* that the legislatively adopted procedures make it easier for a shareholder in a closely held corporation to bring a derivative claim for the corporation and, if justice requires, to receive the recovery for itself.[111]

D. Claims.

1. Breach of Fiduciary Duty.

The most common derivate claim in shareholder disputes is breach of fiduciary duty, which might be brought duty to remedy some allegedly oppressive (or other) conduct. In the case of failure to declare any or higher dividends, those decisions fall within the discretion of the directors. Those decisions must be made in compliance with the fiduciary duties owed to the corporation (or shareholders collectively). If the directors fail to comply with those duties to act solely for the benefit of the corporation and refuse to declare dividends for some improper purpose, one or more shareholders may sue the directors and seek relief directly to the corporation or through a derivative action.[112] But if "the director's decision not to declare dividends is made for the benefit of the corporation, in compliance with the duties of care and loyalty, no relief is warranted. In that instance a director generally will have fulfilled the duties by acting in the best interest of the corporation, even if there was an incidental injury to one or more individual

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[102] TEX. BUS. ORGS. CODE § 21.552.

[103] *In re Schmitz*, 285 S.W.3d 451, 457 (Tex. 2009) (orig. proceeding).

[104] *Id.* at 455-56.

[105] *Id.* at 454-55.

[106] *Redmon v. Griffith*, 202 S.W.3d 225, 234 (Tex. App.—Tyler 2006, pet. denied) ("[T]o recover for wrongs done to the corporation, the shareholder must bring the suit derivatively in the name of the corporation so that each shareholder will be made whole if the corporation obtains compensation from the wrongdoer."); *see, e.g.*, *Swank v. Cunningham*, 258 S.W.3d 647, 661 (Tex. App.—Eastland 2008, pet. denied) (affirming that former corporate executives could not bring individual actions for damages against corporation's attorneys but instead action would be derivative in nature).

[107] TEX. BUS. ORGS. CODE § 21.563(b).

[108] *Sneed*, 465 S.W.3d at 187-88; *Ritchie*, 443 S.E.3d at 881 ("Shareholders in a closely held corporation ... can bring a derivative action without having to prove that they 'fairly and adequately represent[] the interests of' the corporation, without having to make a 'demand' upon the corporation, as in other derivative actions, and without fear of a stay or dismissal based on actions of other corporate actors in response to a demand.") (citations omitted); *see Swank*, 285 S.W.3d at 664-65 (distinguishing the procedural requirements for maintaining a derivative action on behalf of a corporation versus a closely-held corporation).

[109] *Sneed*, 465 S.W.3d at 183-84.

[110] TEX. BUS. ORGS. CODE § 21.563(c); *Sneed*, 465 S.W.3d at 188; *Cardiac Perfusion Servs. v. Hughes*, 436 S.W.3d 790, 791 (Tex. 2014).

[111] *See, e.g.*, *Saden v. Smith*, 415 S.W.3d 450, 462-65 (Tex. App.—Houston [1st Dist.] 2013, pet. denied) (affirming direct recovery by 50% shareholder based on derivative claim submitted as an individual claim).

[112] *Natale v. Espy Corp.*, No. 13-30008-MGM, 2015 WL 3632227, at *6-7 (D. Mass. June 2, 2015) (allowing amendment to assert derivative breach of fiduciary duty claim for "malicious suppression" of dividends).

shareholders."[113] If, however, a director distributes profits exclusively to themselves, such as by inflating their own salaries, in a manner that harms the corporation, that conduct may be in breach of their fiduciary duty to the corporation for which the law affords a remedy. The plaintiff must prove the compensation or bonus is excessive and harmful to the corporation; however, the monies for many derivative claims are for the corporation.[114]

Similarly, if a director improperly terminates a minority shareholder's employment "for no legitimate purpose, intended to benefit the directors or individual shareholders at the expense of the minority shareholder, and harmful to the corporation," that also may support a direct or derivative breach of fiduciary duty claim. That is, such conduct might "violate the directors' fiduciary duties to exercise their 'uncorrupted business judgment for the sole benefit of the corporation' and to refrain from 'usurping corporate opportunities for personal gain.'"[115] Generally, though, the at-will doctrine applies to corporate employment decisions.[116]

Officers and directors owe to the corporation a duty of loyalty that prohibits them "from misapplying corporate assets for their personal gain or wrongfully diverting corporate opportunities to themselves."[117] Failure to abide by that duty again may support a direct or derivative recovery for the corporation. Manipulation of the value of a corporation's stock might give rise to a direct or derivative breach of fiduciary duty claim if harmful to the corporation.[118]

One court reinstated the minority shareholder to the board and granted access to records based on a derivative claim brought by the shareholder.[119] Other courts may not be willing to grant individual relief based on a derivative claim, but courts may fashion other equitable remedies, such as forfeiture or disgorgement.[120]

2. Other Claims or Remedies.

Although breach of fiduciary duty claims are probably most prevalent in shareholder disputes, shareholders also assert other claims derivatively. Misuse of corporate funds and assets might support an unjust enrichment remedy.[121] The derivative claims asserted in *Sneed* included nondisclosures, misrepresentations, negligence, and breach of fiduciary duty.[122]

3. Attorney's Fees and Expenses.

On termination of a derivative proceeding a court may order the corporation to pay the plaintiff's reasonable expenses if it finds the proceeding resulted in a "substantial benefit" to the corporation. The court may also require a plaintiff or other person to pay expenses in certain circumstances. Expenses include attorney's fees, investigation costs, and certain indemnity costs.[123]

V. "GOVERNING PERSONS" AND OFFICERS.

A governing person may, in good faith and with ordinary care, rely on information, opinions, reports or statements prepared and presented by officers, employees, lawyers, CPAs, investment bankers, persons with professional expertise, or another committee of the entity.[124] A governing person also has

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[113] *Ritchie*, 443 S.W.3d at 883-84: *see ARGO Data Resources*, 380 S.W.3d at 275-76 (overturning judgment based shareholder oppression that ordered payment of dividends).

[114] *Boehringer v. Konkel*, 404 S.W.3d 18, 28-30 (Tex. App.—Houston [1st Dist.] 2013, no pet.).

[115] *Ritchie*, 443 S.W.3d at 886.

[116] *Id.* at 882-85 (citing *Patton v. Nicholas*, 279 S.W.2d 848, 849-53 (Tex. 1955), and TEX. BUS. ORGS. CODE §§ 21.301-.303, .310-.313, .551-.563, .714, .726-.727).

[117] *Ritchie*, 443 S.W.3d at 887.

[118] *Id.* at 887-88.

[119] *DeNucci v. Matthews*, 463 S.W.3d 200, 204 (Tex. App.—Austin 2015, no pet.) (affirming reinstatement and access to records).

[120] *See, e.g.*, *In re Life Partners Holdings, Inc.*, No. DR-11-CV-43-AM, 2015 WL 8523103, at *17-18 (W.D. Tex. Nov. 9, 2015) (discussing various equitable remedies in shareholder dispute).

[121] *See, e.g.*, *Kohannim v. Katoli*, 440 S.W.3d 798, 811–13 (Tex. App.—El Paso 2013, pet. denied) (alleged misappropriation of LLC's funds would be company's claim for unjust enrichment); *see also Natale*, 2015 WL 3632227, at *7-8 (allowing amendment to add unjust enrichment).

[122] *Sneed*, 465 S.W.3d at 175-76.

[123] TEX. BUS. ORGS. CODE § 21.561; *see DeNucci*, 463 S.W.3d at 209 (confirming that a minority shareholder should recover from a closely held corporation the attorney's fees he incurred prosecuting the breach of fiduciary duty claim derivatively on behalf of the corporation); *see also Bayoud v. Bayoud*, 797 S.W.2d 304, 315 (Tex. App.—Dallas 1990, writ denied) ("Awarding costs and attorneys' fees to successful plaintiffs in shareholder derivative suits is a well-established practice.")

[124] TEX. BUS. ORGS. CODE §§ 3.102, .105; *see In re Life Partners Holdings, Inc.*, WL 8523103 at *15 (finding that plaintiff shareholder had the burden to show that a life insurance company's directors did not rely on a doctor's life expectancy estimates in good faith); *see also Int'l Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 576-77 (Tex.

a right of inspection, and a court may award attorney's fees and any other proper relief in a suit to require the entity to open its books and records.[125]

VI. CLOSE CORPORATIONS

The Business Organizations Code permits a corporation to declare it to be a "close corporation." Two subchapters of the Code address the special needs of such corporations and exempts them from certain rules that govern other types of corporations.[126] In addition to other available corporate judicial proceedings, close corporations are authorized to institute proceedings to enforce a close corporation provision, appoint a provisional director, or appoint a custodian.[127] In such proceedings, courts must enforce close corporation provisions regardless of whether there is an adequate remedy at law and may enforce them by injunction, specific performance, damages, appointment of provisional director or custodian, appointment of a receiver for specific corporate assets, appointment of a rehabilitative receiver, or appointment of a liquidating receiver, among other things.[128] And the legislature has afforded businesses that elect to operate as close corporations greater contractual liberty.[129]

VII. LIQUIDATING RECEIVER.

The Code allows appointment of a liquidating receiver as follows:

> (a) Subject to Subsection (b), a court that has jurisdiction over the property and business of a domestic entity under Section 11.402(b) may order the liquidation of the property and business of the domestic entity and may appoint a receiver to effect the liquidation:
>
> …
>
> (2) on application of the entity to have its liquidation continued under the supervision of the court;
>
> …
>
> (b) A court may order a liquidation and appoint a receiver under Subsection (a) only if:
>
> (1) the circumstances demand liquidation to avoid damage to interested persons;
> (2) all other requirements of law are complied with; and
> (3) the court determines that all other available legal and equitable remedies, including the appointment of a receiver for specific property of the domestic entity and appointment of a receiver to rehabilitate the domestic entity, are inadequate.
>
> (c) If the condition necessitating the appointment of a receiver under this section is remedied, the receivership shall be terminated immediately, the management of the domestic entity shall be restored to its managerial officials, and the receiver shall redeliver to the domestic entity all of its property remaining in receivership.[130]

VIII. WINDING UP.

An "event requiring a winding up" or "event requiring winding up" is an event in section 11.051:

> (1) the expiration of any <u>period of duration</u> specified in the domestic entity's governing documents;
> (2) a <u>voluntary decision</u> to wind up the domestic entity;
> (3) an <u>event specified in the governing documents</u> of the domestic entity requiring the winding up, dissolution, or termination of the domestic entity, other

App.—Fort Worth 1963)(pet. denied)(discussing fiduciary duties owed by corporate officers and directors to the corporation).

[125] TEX. BUS. ORGS. CODE § 3.152; *Tex. Ear Nose & Throat Consultants*, 470 S.W.3d at 89-91 (discussing fee award to "governing person"). *Cf.* TEX. BUS ORGS. CODE § 153.552 (right of inspection applying to limited partnerships); *Davis v. Middle Bosque Partners, LP*, No. 04-13-00464-CV, 2014 WL 1390496, at *2-3 (Tex. App.—San Antonio April 9, 2014, pet. denied) (mem. op.) (reversing dismissal when member properly sought a declaration of his right to examine all of the books and records of a limited partnership and limited liability company for the period of time in which he was a partner and member).

[126] *See* TEX. BUS. ORGS. CODE §§ 21.701–.732 (general provisions), 21.751–.763 (judicial proceedings); *see also Martin v. Martin*, 326 S.W.3d 741, 753 (Tex. App.—Texarkana 2010, pet. denied) (discussing that a close corporation may be managed either by a board of directors or in the manner provided for in a shareholders' agreement, which may eliminate the board of directors completely and authorize that the corporation be managed by one or more of its shareholders or other persons).

[127] TEX. BUS. ORGS. CODE § 21.752.

[128] *Id.* § 21.756.

[129] *See generally Id.* §§ 1.001, 21.701–.732.

[130] *Id.* § 11.405 (formerly TEX. BUS. CORP. ACT art. 7.06).

than an event specified in another subdivision of this section;

(4) an event specified in other sections of this code requiring the winding up or termination of the domestic entity, other than an event specified in another subdivision of this section; or

(5) a **decree by a court requiring the winding up, dissolution, or termination of the domestic entity**, rendered under this code or other law.[131]

For purposes of Section 11.051(3), the event requiring the winding up [for a domestic corporation], dissolution, or termination of a domestic corporation must be specified in:

(1) the certificate of formation of the corporation; or

(2) a bylaw of the corporation adopted by the owners or members of the corporation in the same manner as an amendment to the certificate of formation of the corporation.[132]

A court may order the involuntary windup and termination of an entity on the action of the attorney general for the following reasons:

(a) A court may enter a decree requiring winding up of a filing entity's business and termination of the filing entity's existence if, as the result of an action brought under Section 11.303, the court finds that one or more of the following problems exist:

(1) the filing entity or its organizers did not comply with a condition precedent to its formation;

(2) the certificate of formation of the filing entity or any amendment to the certificate of formation was fraudulently filed;

(3) a misrepresentation of a material matter has been made in an application, report, affidavit, or other document submitted by the filing entity under this code;

(4) the filing entity has continued to transact business beyond the scope of the purpose of the filing entity as expressed in its certificate of formation; or

(5) public interest requires winding up and termination of the filing entity because:

(A) the filing entity has been convicted of a felony or a high managerial agent of the filing entity has been convicted of a felony committed in the conduct of the filing entity's affairs;

(B) the filing entity or high managerial agent has engaged in a persistent course of felonious conduct; and

(C) termination is necessary to prevent future felonious conduct of the same character.

(b) Sections 11.302-11.307 do not apply to Subsection (a)(5).[133]

Moreover, the court has broad powers in supervising the windup of a domestic entity:

Subject to the other provisions of this code, on application of a domestic entity or an owner or member of a domestic entity, a court may:

(1) supervise the winding up of the domestic entity;

(2) appoint a person to carry out the winding up of the domestic entity; and

(3) make any other order, direction, or inquiry that the circumstances may require.[134]

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[131] *Id.* §§ 11.001, .051 (emphasis added).

[132] *Id.* § 11.059; *see, e.g., Baywood Country Club v. Estep*, 929 S.W.2d 532, 537 (Tex. App.—Houston [1st Dist.] 1996, writ. denied) (affirming that a corporation's "sustaining" members should share in the proceeds of the corporation's dissolution when the corporation's articles of incorporation were correctly amended to reflect their right to receive proceeds).

[133] TEX. BUS. ORGS. CODE § 11.301; *see Lone Star Bldg. & Loan Ass'n v. State*, 153 S.W.2d 219, 221-22 (Tex. Civ. App.—Austin 1941, writ dism'd) (affirming trial court's grant of the State's request for the appointment of a receiver when association was unsound and insolvent and was conducting fraudulent business practices); *cf. Mueller v. Beamalloy, Inc.*, 994 S.W.2d 855, 859 (Tex. App.—Houston [1st Dist.] 1999, no pet.) (noting that granting liquidating receivership for a corporation is "only as a last resort" when the less harsh remedies of appointment of a receiver for specific assets or a rehabilitative receiver are inadequate).

[134] TEX. BUS. ORGS. CODE § 11.054; *see, e.g., In re Waggoner Estate*, 163 S.W.3d 161, 169-71 (Tex. App.—Amarillo 2005, no pet.) (affirming court's appointment of receiver and direction that receiver sell the business's assets subject to the court's supervision when the articles and

One court held that the authority to appoint a "person" to windup the entity did not authorize appointment of a receiver.[135]

IX. CONCLUSION

While *Ritchie* refused to recognize a common-law (or statutory-based) shareholder oppression claim, as *Ritchie* and *Sneed* demonstrate, other mechanisms exist to deal with shareholder disputes. Advance agreements that deal with various situations, including employment, buy-sell options, retirement, death, or other potential changes, can also prevent or resolve changes or disputes without requiring or reaching litigation.

bylaws required liquidation); *see Burnett v. Chase Oil & Gas, Inc.*, 700 S.W.2d 737, 741 (Tex. App.—Tyler 1985, no pet.) (noting that a corporation dealing with voluntary dissolution may apply for court supervision of its liquidation).

[135] *Spiritas*, 459 S.W.3d at 235.