

**Presented:**  
2012 SECURITIES REGULATION AND BUSINESS LAW CONFERENCE  
February 10, 2012  
Dallas, TX

**CLAIMS FOR OPPRESSION BY  
MINORITY SHAREHOLDERS IN PRIVATE  
COMPANIES UNDER TEXAS AND DELAWARE LAW:  
A PLAINTIFF'S PERSPECTIVE**

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## A. INTRODUCTION

A favorite Willie Nelson song cautions mothers not to let their babies grow up to be cowboys. If Willie had been asked to offer guidance to mothers of investors in private Texas companies, however, he might have changed his lyrics to, “Mamas don’t let your babies grow up to be minority shareholders without a redemption agreement.” This version of Willie’s song would likely be a dud on country radio, but it is sage advice.

An investor who buys a minority ownership stake in a private Texas company without an exit strategy in place is likely to be “locked in” to (and unable to dispose of) his investment in the business long after he desires to sell. Unless the minority investor obtains a redemption agreement (or some other contractual right to exit the business) at the time he buys his stock, he lacks the right to choose the point at which he can later “monetize” his investment. In most cases, there is no market for a minority shareholder’s stock in a private company. Further in the absence of a redemption agreement with the company or other shareholders, the company and the other shareholders have no obligation to buy the minority shareholder’s stock for any price. This leaves the minority shareholder with no option to dispose of his shares and hoping for a liquidity event such as a sale of the business, a merger, or an Initial Public Offering (IPO).

This article focuses on conflicts among minority and majority owners of privately-held Texas companies. While litigation is on the rise in this area, the spate of claims by minority shareholders is only now reaching the appellate courts and there are not yet an extensive number of appellate decisions dealing with these issues. As Texas courts start to grapple with claims by minority shareholders, however, they are reexamining the rights and duties of majority owners of private companies.

In this troubled economy, claims and lawsuits by minority shareholders, limited partners and LLC members in private Texas companies appear to be increasing. Although this article does not include a statistical analysis of this perceived trend, the common sense explanation is that a down economy eliminates, or sharply reduces, the prospect for minority owners in private companies to cash out.<sup>1</sup> As a result, many investors/owners in private businesses have become frustrated by the structural and economic inability to monetize their investments. In the wake of this frustration, and after concluding that their rights have been violated by majority owners who abused their control of the business to operate the company in a manner that is hostile to and oppressive of the minority owners, these minority investors are turning to the courts.<sup>2</sup>

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<sup>1</sup> The dearth of IPO filings in the early 2000’s has not persisted. In late 2004, Barron’s reported that this year had been a “tour de force” for new stock issues and that 205 stocks went public during 2004 raising a total of \$41 billion. This compares with 73 stocks that went public in 2003 and a peak of 864 that went public during 1996. Among the IPO’s of 2004 were Google, Texas Roadhouse restaurants and NavTeq, which was 41% owned by Phillips Electronics. IPO filings were down slightly in 2005 from 2004, but still greatly outpaced the number of offerings in 2003.

<sup>2</sup> For the purposes of this article, the assumption is made that the minority owner does not have a shareholder’s agreement or any other contractual right that would force a buyout of his or its interest by the majority owners for the fair value of that interest.

From a plaintiff's perspective, the good news is that all hope is not lost for minority investors who do not obtain a redemption agreement before they invest in a private company in Texas. Texas courts have recognized that minority shareholders in private companies do have "exit rights" if they can establish that they were "oppressed" by the conduct of the majority shareholder(s). In these limited circumstances, minority shareholders may be able to secure a court-ordered remedy that provides them with value for their ownership interest in the company.

## **B. THE CLOSELY HELD (PRIVATE) CORPORATION**

The "minority shareholder oppression" scenario arises uniquely in the context of the private company, including the close corporation. An investor in a large, publicly-held corporation can certainly feel oppressed, *i.e.*, that his investment goals are being thwarted by the management's operation of the company or that management has engaged in "bad acts." The public company investor has a ready exit available, however, because his shares may be readily sold in the open market.<sup>3</sup> As previously noted, a shareholder in a closely held company lacks this option, because typically there is no market for the shares of a private company. Moreover, in many close corporations, a shareholder's agreement includes restrictions on the stock's sale or transfer by the minority shareholder. The non-marketable nature of an investment in a private company makes it possible for controlling shareholders to "squeeze out" the minority shareholder from the company's management and daily operations, while also "freezing out" the minority owner's ability to cash out on or realize other monetary benefits from his or its investment.

By definition, a minority shareholder, minority member of an LLC and limited partner lacks control over the business. In the corporate context, shareholders elect the board of directors, which gives the majority shareholder the right through control of the board to, among other things: (i) select the officers, (ii) set officer compensation, (iii) determine whether the company will issue any dividends and, if so, (iv) how much of a dividend to issue to the minority owners. In the LLC context, the majority members have the power to appoint the managers and achieve the same results described above. The majority shareholder(s) or LLC member(s) can deny the minority owner the right to participate in the management of the business, and the right to share in the financial success of the business on a current basis (*i.e.*, the denial of dividends).

In a limited partnership, the operational control belongs to the general partner, and the limited partners are not generally active in the business, although the limited partnership act does allow limited partners some leeway, including the ability to consult with (and advise) general partners and to also call, attend and participate in meetings with both the limited and the general partners. TEX. BUS. ORG. CODE § 153.103 (Vernon's 2010).

In most cases, the successful functioning of a closely held corporation, LLC or limited partnership depends on the relationship of trust that exists among the owners of the business and the way in which they run the company and share in its financial success. When the majority owners abuse their power and control over the company, trust ends and problems follow.

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<sup>3</sup> The minority shareholder in a public company may also have a variety of state and federal securities claims to pursue, but these claims are beyond the scope of this article.



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First appeared as part of the conference materials for the  
34<sup>th</sup> Annual Conference on Securities Regulation and Business Law session  
"Ripe Fruit or Withered on the Vine: Plaintiff and Defense Perspectives under Texas and Delaware Law"