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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 Electrottype 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

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

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