How to Deal with Fiduciary Duties in Conflict Transactions In Texas and Delaware

By

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CHAPTER 1. INTRODUCTION

Both Texas[1] and Delaware[2] have well developed bodies of statutory and case law governing corporations, partnerships and limited liability companies ("***LLCs***"). Generally the statutes in both states leave to the common law the fiduciary duty "issues" that arise whenever directors, officers or controlling persons deal with their corporations, partnerships or LLCs. Whether the "issue" becomes a "problem" or "fiduciary duty breach" is usually determined by how the board of directors or other governing persons (collectively, the "***Board***") of the entity address and resolve or otherwise deal with the issue. This paper will address the Texas and Delaware case and statutory law regarding this subject.

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Byron F. Egan is a partner of Jackson Walker L.L.P. in Dallas, Texas. Mr. Egan is a member of the ABA Business Law Section's Mergers & Acquisitions Committee, serves as Senior Vice Chair of the Committee and Chair of its Executive Council and served as Co-Chair of its Asset Acquisition Agreement Task Force which prepared the ABA Model Asset Purchase Agreement with Commentary. Mr. Egan is the author of *EGAN ON ENTITIES: Corporations, Partnerships and Limited Liability Companies in Texas* (2nd Ed. 2018) ("***EGAN ON ENTITIES***"), which addresses the formation, governance and sale of business entities, including an analysis of the fiduciary duties of their governing persons in a variety of situations. EGAN ON ENTITIES is available from Corporation Service Company and LexisNexis: https://www.cscglobal.com/blog/csc-publishing-egan-on-entities/

[1] In 2006, the Texas Legislature enacted the Texas Business Organizations Code (the "***TBOC***") which codifies the Texas statutes relating to business entities, together with the Texas statutes governing the formation and operation of other for-profit and non-profit private sector entities. The TBOC is principally a codification of the existing Texas statutes governing for-profit and non-profit private-sector entities, rather than substantive modifications to existing law. These Texas statutes, which are now repealed and replaced by the TBOC, consisted of the following: the Texas Business Corporation Act (the "***TBCA***"), the Texas Non-Profit Corporation Act (the "***TNPCA***"), the Texas Miscellaneous Corporation Laws Act (the "***TMCLA***"), the Texas Limited Liability Company Act (the "***LLC Act***"), the Texas Revised Partnership Act (the "***TRPA***"), the Texas Revised Limited Partnership Act (the "***TRLPA***"), The Texas Real Estate Investment Trust Act (the "***TREITA***"), the Texas Uniform Unincorporated Nonprofit Associations Act ("***TUUNA***"), the Texas Professional Corporation Act (the "***TPCA***"), the Texas Professional Associations Act (the "***TPAA***"), the Texas Cooperative Associations Act (the "***TCAA***"). The TBOC is applicable to entities formed or converting to another entity form under Texas law after January 1, 2006. Entities in existence on January 1, 2006 could continue to be governed by the Texas source statutes until January 1, 2010, after which time they must conform to the TBOC. The TBCA is continually being updated and improved through the efforts of the Texas Business Law Foundation and the Business Law Section of the State Bar of Texas in an effort to make Texas a more attractive jurisdiction for the organization of entities. This updating process continued in the 86th Texas Legislature, Regular Session (the "***2019 Legislative Session***"), which convened on January 11, 2019 and adjourned on May 27, 2019.

[2] The Delaware statutes governing corporations, partnerships (general and limited) and LLCs include the Delaware General Corporation Law (the "***DGCL***"), the Delaware Revised Uniform Partnership Act ("***DRPA***"), the Delaware Revised Limited Partnership Act ("***DRLPA***") and the Delaware Limited Liability Company Act (the "***DLLCA***").

The fiduciary duties of directors or other governing persons of a corporation, LLC or limited partnership ("***LP***") and its officers are generally owed to the entity they serve and not to any individual owners.[3] Thus, a cause of action against a director or other governing person of an entity and its officers for breach of fiduciary duty would be vested in, and brought by or in the right of, the entity.[4] Statutes in both Texas[5] and Delaware[6] authorize derivative action to be brought in the right of the entity by an owner against its Board for breach of fiduciary duty, although Texas and Delaware also recognize situations where a derivative claim may be treated by the court as a direct action by the injured stakeholder.[7] Since the cause of action belongs to the entity and the power to manage the business and affairs of an entity generally resides in its Board,[8] a disinterested Board would generally have the power to determine whether to bring or dismiss a breach of fiduciary duty claim for the entity.[9]

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3 *Somers v. Crane*, 295 S.W.3d 5, 11-12 (Tex. App.—Houston [1st Dist.] 2009, pet. denied); *R2 Enterprises v. Whipple*, No. 2-07-257-CV, 2008 WL 2553444, 2008 Tex. App. LEXIS 4780 (Tex. App.—Fort Worth 2008) ("An individual stakeholder in a legal entity does not have a right to recover personally for harms done to the legal entity. *Wingate v. Hajdik*, 795 S.W.2d 717, 719 (Tex. 1990), *superseded by statute as stated in Sneed v. Webre*, 465 S.W.3d 169, 188 (Tex. 2015); *Nauslar v. Coors Brewing Co.*, 170 S.W.3d 242, 250 (Tex. App.—Dallas 2005, no pet.) (applying rule to partnerships). A stakeholder does not have standing to seek damages on a cause of action belonging to an entity alone, such as when the damages are based on diminution of the entity's worth or the entity's loss of profits."). *See* EGAN ON ENTITIES at notes 578, 630-739, 766-768.

4 *Redmon v. Griffith*, 202 S.W.3d 225, 233-234 (Tex. App.—Tyler 2006, pet. denied), *disapproved of by Ritchie v. Rupe*, 443 S.W.3d 856 (Tex. 2014); *Somers v. Crane*, 295 S.W.3d 5, 11-12 (Tex. App.—Houston [1st Dist.] 2009, pet. denied) ("[B]ecause of the abundant authority stating that a director's or officer's fiduciary duty runs only to the corporation, not to individual shareholders, we decline to recognize the existence of a fiduciary relationship owed directly by a director to a shareholder in the context of a cash-out merger. Accordingly, we hold that the Class cannot bring a cause of action directly against appellees for breach of fiduciary duty."); *A. Copeland Enters., Inc. v. Guste*, 706 F. Supp. 1283, 1288 (W.D. Tex. 1989) ("Claims concerning breach of a corporate director's fiduciary duties can only be brought by a shareholder in a derivative suit because a director's duties run to the corporation, not to the shareholder in his own right.").

5 The TBOC provides that the TBOC provisions applicable to corporations (TBOC Titles 1 and 2) may be officially and collectively known as "***Texas Corporation Law***," however, because until 2010 some Texas for-profit corporations were governed by the TBCA and others by the TBOC, and because the substantive principles under both statutes are generally the same, the term "***Tex. Corp. Stats***" is used herein to refer to the TBOC and the TBCA (as supplemented by the TMCLA) collectively. The TBOC provisions relating to corporate derivative actions are in §§ 21.551-21.563; TBCA art. 5.14.

6 Del. Ct. of Chancery R. 23.1.

7 TBOC § 21.563 (permitting a claim by a shareholder of a closely held corporation to be treated as a direct claim if justice requires); *Moroney v. Moroney*, 286 S.W. 167, 170 (Tex. Com. App. 1926) (applying Texas law and allowing the shareholder to pursue a direct claim for payment of dividends, reasoning that the claim "is not so much an action by the wards to recover damages to their stock, as it is to recover a loss of specific profits they would have earned"); *see 2055 Inc. v. McTague*, No. 05-08-01057-CV, 2009 WL 2506342, at *8 (Tex. App.—Dallas Aug. 18, 2009, no pet) (mem.op.) and *EGAN ON ENTITITES* § 2.6.7.

8 *See* Delaware Chancery Court Rule 23.1 and DGCL § 141(a) for corporations, and Delaware Chancery Court Rule 2.3.2 and DRLPA § § 17-001-17-003 for LPs and DLLCA § § 18-001-18-004 for LLCs; *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244, 253-54 (Del. 2000). The TBOC provisions governing derivative proceedings for corporations are in TBOC § § 21.551-21.560, for LLCs are in TBOC § 101.451 – 463 and for LPs are in TBOC § 153.401 – 153.413.

9 *See EGAN ON ENTITITES* § 2.6.7; *Wingate v. Hajdik*, 795 S.W.2d 717, 719 (Tex. 1990), *superseded by statute as stated in Sneed v. Webre*, 465 S.W.3d 169, 188 (Tex. 2015) ("Ordinarily, the cause of action for injury to the property of a corporation, or the impairment or destruction of its business, is vested in the corporation, as distinguished from its stockholders . . . ."); *Pace v. Jordan*, 999 S.W.2d 615, 622 (Tex. App.—Houston [1st Dist.] 1999, pet. denied) (noting that "[a] corporation's directors, not its shareholders, have the right to control litigation of corporate causes of action").

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