BUSINESS DIVORCE:
MINORITY SHAREHOLDER RIGHTS IN TEXAS

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David maintains an active trial and appellate practice in the trusts, estates, and closely-held business area. David is the primary author of the Texas Fiduciary Litigator blog (txfiduciarylitigator.com), which reports on legal cases and issues impacting the fiduciary field in Texas. David's recent trial experience includes:

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> Representing the majority owner in a limited partnership regarding a business divorce from a minority owner and former employee.
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> Representing the majority owner in a business divorce from a minority owner who owned convertible notes.
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> Represented a trustee and minority owner in a closely held business dispute regarding the non-owner managers overcompensating themselves.
>
> Representing a trustee and the minority owner of a business in a business divorce from the majority owners where the client was alleged to have overcompensated himself.
>
> Representing wife in fiduciary claims against husband arising from closely-held businesses in a divorce proceeding.
>
> Representing limited partner in suit regarding general partner's abusive conduct and unfair offer to purchase interests.

David is one of twenty attorneys in the state (of the 84,000 licensed) that has the triple Board Certification in Civil Trial Law, Civil Appellate, and Personal Injury Trial Law by the Texas Board of Legal Specialization. Additionally, David is a board member of the Texas Board of Legal Specialization and was a member of the Civil Trial Law Commission, which wrote the exam for new applicants for civil trial law certification. David is a graduate of Baylor University School of Law, *Magna Cum Laude*, and Baylor University, B.B.A. in Accounting.

David has published over twenty (20) law review articles on various litigation topics. David's articles have been cited as authority by: federal courts, the Texas Supreme Court (three times), the Texas courts of appeals, and various treatises and law reviews. David has presented and/or prepared written materials for over two hundred (200) continuing legal education courses.

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I. INTRODUCTION

Everything is always rosy when business owners start a business. They are good friends or family members and trust each other. They never think that the other could do anything to hurt them or their business. Unfortunately, it is all too common for closely held businesses to break up, and that break up can be very painful (both emotionally and financially). The majority owner can take certain actions to freeze out the minority owner from the business operations and decisions, fail to disclose information, fail to make distributions, take business assets and redirect business opportunities and otherwise harm the minority shareholder and/or the business. What is the minority owner to do? This article addresses many of the rights and remedies that the minority owner has when the majority owner begins to act inappropriately.

II. TEXAS HAS NO SHAREHOLDER OPPRESSION CLAIM

When there is a dispute between the majority and a minority shareholder, the minority shareholder will likely want to exit the relationship and obtain fair compensation for his or her shares. Texas has no statute, however, that requires majority shareholders to buy-out a minority shareholder at a fair price and otherwise does not allow a cause of action and damages for shareholder oppression. Does the common law allow for such a claim?

Typically, shareholder oppression involves a majority shareholder or shareholders taking actions to oppress or disenfranchise minority shareholders in some way. This may include: terminating the minority shareholder as an employee and ending compensation, failing to disclose company information, refusing to allow minority shareholder to make management decisions, refusing to make distributions or dividends, refusing to buy back a minority shareholder's interests and locking them in or trapping them, offering less than fair value for the interests, refusing to let the minority shareholder transfer his or her interests, taking actions that devalue the interests, etc. Many jurisdictions hold that majority owners owe duties to minority shareholders, and that there was a claim for shareholder oppression that requires a majority shareholder to buy-out a minority shareholder at a fair price.

Historically, many courts in Texas held that common-law did allow such a claim. *See, e.g., Christians v. Stafford*, No. 14-99-00038-CV, 2000 Tex. App. LEXIS 6423, 2000 WL 1591000, at *2 (Tex. App.—Houston [14th Dist.] Oct. 26, 2000, no pet.) (mem. op.) ("[A] court may order an equitable 'buy-out' of a party's minority shares for oppressive acts of the majority when the party sues both individually in his own right and as a shareholder on behalf of the corporation."); *Advance Marine, Inc. v. Kelley*, No. 01-90-00645-CV, 1991 Tex. App. LEXIS 1614, 1991 WL 114463, at *2 (Tex. App.—Houston [1st Dist.] June 27, 1991, no writ) (mem. op.) ("Courts have power to order the equitable remedy of a buy-out by the majority shareholders according to the facts of the particular case."); *see also Balias v. Balias, Inc*, 748 S.W.2d 253, 256-57 (Tex. App.—Houston [14th Dist.] 1988, writ denied) (affirming trial court's denial of appointment of a receiver where shareholder failed to demonstrate that other remedies would have been inadequate).

However, in *Ritchie v. Rupe*, the Texas Supreme Court held that there was no such claim in Texas. 443 S.W.3d 856 (Tex. 2014). In *Ritchie*, the Court held that Texas had a receivership statute that expressly allowed a party to seek and obtain a rehabilitative receivership when there was shareholder oppression. *Id*. The Court held that the receivership statute did not provide authority for any other remedies: "The statute does not create a cause of action for unspecified lesser remedies that are not otherwise available under the law; the only cause of action the statute creates is for receivership." *Id*. at 875.

The Court then held that it would not approve of any other remedy or cause of action for shareholder oppression claims. The Court explained the process in determining whether to recognize a common-law cause of action:

> When deciding whether to recognize "a new cause of action and the accompanying expansion of duty," the Court "perform[s] something akin to a cost-benefit analysis to assure that this expansion of liability is justified." The analysis is complex, requiring consideration of a number of non-dispositive factors including, but not limited to: the foreseeability, likelihood, and magnitude of the risk of injury, the existence and adequacy of other protections against the risk, the magnitude of the burden of guarding against the injury and the consequences of placing that burden on the persons in question, and the consequences of imposing the new duty, including whether Texas's public policies are served or disserved whether the new duty may upset legislative balancing-of-interests, and the extent to which the new duty provides clear standards of conduct so as to deter undesirable conduct without impeding desirable conduct or unduly restricting freedoms.

Id. at 878. Under this framework, the Court then undertook a lengthy analysis of whether to recognize common-law shareholder oppression claims. The Court first held that harm from oppressive conduct was foreseeable, likely, and potentially large in magnitude:

> Our review of the case law and other authorities also convinces us that it is both foreseeable and likely that some directors and majority shareholders of closely held corporations will engage in such actions with a meaningful degree of frequency and that minority shareholders typically will suffer some injury as a result. Although the injury is usually merely economic in nature, it can be quite substantial from the minority shareholder's perspective, as it often completely undermines their sole or primary motivation for engaging with the business. We thus conclude that the foreseeability, likelihood, and magnitude of harm sustained by minority shareholders due to the abuse of power by those in control of a closely held corporation is significant, and Texas law should ensure that remedies exist to appropriately address such harm when the underlying actions are wrongful.

Id. at 879.

The Court then held that there were other means and remedies available for oppressive conduct and acknowledged that there was a gap in protection: "We recognize that our conclusion leaves a 'gap' in the protection that the law affords to individual minority shareholders, and we acknowledge that we could fill the gap by imposing a common-law duty on directors in closely held corporations not to take oppressive actions against an individual shareholder even if doing so is in the best interest of the corporation." *Id*. However, the Court found that "the public policies at play, the consequences of imposing the duty, the duty's social utility, and whether the duty would conflict with existing law or upset the Legislature's careful balancing of competing interests in governing business relationships" weighed in favor of not recognizing a common law cause of action. The Court concluded:

> The Legislature has crafted a statutory scheme governing domestic corporations. The statutes are detailed and extensive, reflecting legislative policy judgments about when the government should step in to impose rights and obligations on the parties and when the parties should be free to dictate their own rights and obligations vis-à-vis each other and the business. This Court has the prerogative to superimpose a common-law cause of action upon this statutory framework—though not to alter or contravene the statutory framework—but we exercise that power sparingly, careful not to upset the Legislative balance of policies, and only when warranted by a genuine need. We find no such necessity here, and therefore decline to recognize a common-law cause of action for "shareholder oppression."

Id. at 891. Accordingly, in Texas, unlike most other jurisdictions, there is no common-law claim for shareholder oppression and no common-law right to force a buy-out of a minority shareholder's shares for a fair price. As there are no statutory or common law rights, a minority shareholder and his or her attorney must know what rights that he or she does have to provide leverage to obtain a fair business divorce.

III. SALE OF OWNERSHIP INTEREST

One method that a minority owner may have to exit a business is to simply sell their interest to a third party. This is rarely a viable option, however. First, independent third parties would rarely want to pay adequate consideration to enter into a business when they have few management rights. Second, even if such a third party could be found, there are normally restrictions in the governing documents that preclude an owner from selling his or her interest to a third party without the consent of the other owners.

Regarding restrictions on transfer of ownership interests, the Texas Organizations Code provides:

> (d) A certificate representing ownership interests that is subject to a restriction, placed by or agreed to by the domestic entity under this code, or otherwise contained in its governing documents, on the transfer or registration of the transfer of the ownership interests must:
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> (1) conspicuously state or provide a summary of the restriction on the front of the certificate;
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> (2) state the restriction on the back of the certificate and conspicuously refer to that statement on the front of the certificate; or
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> (3) conspicuously state on the front or back of the certificate that a restriction exists pursuant to a specified document and: (A) that the domestic entity, on written request to the entity's principal place of business,

> will provide a free copy of the document to the certificate record holder; or (B) if the document has been filed in accordance with this code, that the document: (i) is on file with the secretary of state or, in the case of a real estate investment trust, with the county clerk of the county in which the real estate investment trust's principal place of business is located; and (ii) contains a complete statement of the restriction.
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> (e) A domestic entity that fails to provide to the record holder of a certificate within a reasonable time a document as required by Subsection (d)(3)(A) may not enforce the entity's rights under the restriction imposed on the certificated ownership interests.

Tex. Bus. Orgs. Code § 3.202(d), (e). To determine whether a particular ownership interest is subject to certification requirement, a party should review Texas Business Organizations Code Section 3.201.

Regarding corporations, the Code states:

> (a) A restriction on the transfer or registration of transfer of a security, or on the amount of a corporation's securities that may be owned by a person or group of persons, may be imposed by: (1) the corporation's certificate of formation; (2) the corporation's bylaws; (3) a written agreement among two or more holders of the securities; or (4) a written agreement among one or more holders of the securities and the corporation if: (A) the corporation files a copy of the agreement at the principal place of business or registered office of the corporation; and (B) the copy of the agreement is subject to the same right of examination by a shareholder of the corporation, in person or by agent, attorney, or accountant, as the books and records of the corporation.
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> (b) A restriction imposed under Subsection (a) is not valid with respect to a security issued before the restriction has been adopted, unless the holder of the security voted in favor of the restriction or is a party to the agreement imposing the restriction.

Id. at § 21.210. Further, the Code provides that the following restrictions are generally reasonable:

> (a) Without limiting the general powers granted by Sections 21.210 and 21.213 to impose and enforce reasonable restrictions, a restriction placed on the transfer or registration of transfer of a security of a corporation is valid if the restriction reasonably: (1) obligates the holder of the restricted security to offer a person, including the corporation or other holders of securities of the corporation, an opportunity to acquire the restricted security within a reasonable time before the transfer; (2) obligates the corporation, to the extent provided by this code, or another person to purchase securities that are the subject of an agreement relating to the purchase and sale of the restricted security; (3) requires the corporation or the holders of a class of the corporation's securities to consent to a proposed transfer of the restricted security or to approve the proposed transferee of the restricted security for the purpose of preventing a violation of law; (4) prohibits the transfer of the restricted security to a designated person or group of persons and the designation is not manifestly unreasonable; (5) maintains the status of the corporation as an electing small business corporation under Subchapter S of the Internal Revenue Code; (6) maintains a tax advantage to the corporation; (7) maintains the status of the corporation as a close corporation under Subchapter O; (8) obligates the holder of the restricted securities to sell or transfer an amount of restricted securities to a person or group of persons, including the corporation or other holders of securities of the corporation; or (9) causes or results in the automatic sale or transfer of an amount of restricted securities to a person or group of persons, including the corporation or other holders of securities of the corporation.

Id. at § 21.211(a). Section 21.213 states:

> (a) A restriction placed on the transfer or registration of the transfer of a security of a corporation is specifically enforceable against the holder, or a successor or transferee of the holder, if: (1) the restriction is reasonable and noted conspicuously on the certificate or other instrument representing the security; or (2) with respect to an uncertificated security, the restriction is reasonable and a notation of the restriction is contained in the notice sent with respect to the security under Section 3.205.

Id. at § 21.213(a). Otherwise, "an otherwise enforceable restriction is ineffective against a transferee for value without actual knowledge of the restriction at the time of the transfer or against a subsequent transferee, regardless of whether the transfer is for value." *Id.* at § 21.213(b).

If the proper notice and procedures are followed, a restriction on transferability of a corporation's stock is enforceable. A minority shareholder can potentially be "locked in" and unable to transfer his or her shares. The best way to avoid this result is to have a well-drafted shareholder agreement that allows for a fair separation and business divorce.

IV. SHAREHOLDER AGREEMENTS

The owners of a corporation may enter into shareholder agreements. In *Richie*, the Texas Supreme Court stated: "Shareholders of closely-held corporations may address and resolve such difficulties by entering into shareholder agreements that contain buy-sell, first refusal, or redemption provisions that reflect their mutual expectations and agreements." 443 S.W.3d at 871.

Regarding shareholder agreements, the Texas Business Organizations Code provides:

> (a) The shareholders of a corporation may enter into an agreement that: (1) restricts the discretion or powers of the board of directors; (2) eliminates the board of directors and authorizes the business and affairs of the corporation to be managed, wholly or partly, by one or more of its shareholders or other persons; (3) establishes the individuals who shall serve as directors or officers of the corporation; (4) determines the term of office, manner of selection or removal, or terms or conditions of employment of a director, officer, or other employee of the corporation, regardless of the length of employment; (5) governs the authorization or making of distributions whether in proportion to ownership of shares, subject to Section 21.303; (6) determines the manner in which profits and losses will be apportioned; (7) governs, in general or with regard to specific matters, the exercise or division of voting power by and between the shareholders, directors, or other persons, including use of disproportionate voting rights or director proxies; (8) establishes the terms of an agreement for the transfer or use of property or for the provision of services between the corporation and another person, including a shareholder, director, officer, or employee of the corporation; (9) authorizes arbitration or grants authority to a shareholder or other person to resolve any issue about which there is a deadlock among the directors, shareholders, or other persons authorized to manage the corporation; (10) requires winding up and termination of the corporation at the request of one or more shareholders or on the occurrence of a specified event or contingency, in which case the winding up and termination of the corporation will proceed as if all of the shareholders had consented in writing to the winding up and termination as provided by Subchapter K; (11) with regard to one or more social purposes specified in the corporation's certificate of formation, governs the exercise of corporate powers, the management of the operations and affairs of the corporation, the approval by shareholders or other persons of corporate actions, or the relationship among the shareholders, the directors, and the corporation; or (12) otherwise governs the exercise of corporate powers, the management of the business and affairs of the corporation, or the relationship among the shareholders, the directors, and the corporation as if the corporation were a partnership or in a manner that would otherwise be appropriate only among partners and not contrary to public policy.
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> (b) A shareholders' agreement authorized by this section must be: (1) contained in: (A) the certificate of formation or bylaws if approved by all of the shareholders at the time of the agreement; or (B) a written agreement that is: (i) signed by all of the shareholders at the time of the agreement; and (ii) made known to the corporation; and (2) amended only by all of the shareholders at the time of the amendment, unless the agreement provides otherwise.

Tex. Bus. Orgs. Code § 21.101. *See Batey v. Droluk*, No. 01-12-01058-CV, 2014 Tex. App. LEXIS 3979 (Tex. App.—Houston [1st Dist.] Apr. 10, 2014, no pet.) (limitations in shareholder agreement was effective).

If properly executed, such an agreement is enforceable: "A shareholders' agreement that complies with this subchapter is effective among the shareholders and between the shareholders and the corporation even if the terms of the agreement are inconsistent with this code." Tex. Bus. Orgs. Code § 21.104; *Skeels v. Suder*, No. 02-18-00112-CV, 2021 Tex. App. LEXIS 4810 (Tex. App.—Fort Worth June 17, 2021, no pet. history). The term of the agreement must be in the agreement. *Id*. at § 21.012.

The court in *Skeels v. Suder*, stated: "a shareholder agreement, signed by all shareholders and 'made known' to the corporation, governs corporate action notwithstanding a contrary provision in the BOC. And shareholders are, therefore, free to agree to stricter or more lenient rights than those provided in the BOC. Accordingly, the terms of any share redemption may be provided in a governing document or an applicable agreement among the members, even if the document or agreement is broader or narrower than the dictates of the BOC." No. 02-18-00112-CV, 2021 Tex. App. LEXIS 4810 (Tex. App.—Fort Worth June 17, 2021, no pet. history) (internal citations omitted).

There are notice requirements. Tex. Bus. Orgs. Code § 21.103. If a purchaser of shares does not have knowledge of the existence of a shareholder agreement, it is entitled to rescind the purchase. *Id*. at § 21.105(a). An action to enforce the right of rescission must be commenced not later than the earlier of: (1) the 90th day after the date the existence of the shareholder agreement is discovered; or (2) the second anniversary of the purchase date of the shares. *Id*. at § 21.105(c).

A shareholders' agreement ceases to be effective when shares of the corporation are: (1) listed on a national securities exchange; or (2) regularly traded in a market maintained by one or more members of a national or affiliated securities association. *Id*. at § 21.109(a). The Code does not limit other shareholder agreements: "This subchapter does not prohibit or impair any agreement between two or more shareholders, or between the corporation and one or more of the corporation's shareholders, permitted by Title 1, this chapter, or other law." *Id*. at § 21.110.

A. Buy-Out/Buy-Sell Rights

The easiest solution to a closely held business dispute would be for a minority shareholder to be able force the majority owner or owners to buy the minority owner's interest out of the business so that they can go on their merry way. The parties should first look to the entity's shareholder agreements and formation documents to determine what rights that they have to force a buy-out and under what price. A buy-sell agreement allows business owners to plan in advance for how an owner and the business will part ways upon the occurrence of certain triggering events such as the death or disability of an owner, the voluntary decision to terminate ownership either through a routine sale of stock or through retirement, or the company's decision to part ways with the owner with or without cause. A buy-sell agreement will typically provide for an assessment of the business's value in one of three ways: an agreed-upon value; fair market value at the time of sale; or use of a formula to determine value.

There must be a binding buy-out agreement. Where properly proved, a buy-sell agreement can be an oral agreement. *Yazdani-Beioky v. Sharifan*, 550 S.W.3d 808, 829(Tex. App.—Houston [14th Dist.] 2018, pet. denied) (affirming trial court's finding that an oral agreement to sell an interest in a business was enforceable). Where the documents are unambiguous, the parties must follow the rights and procedures outlined in the document. *See AON Props., Inc. v. Riveraine Corp.*, No. 14-96-00229-CV,1999 Tex. App. LEXIS 199, 1999 WL 12739 (Tex. App.—Houston [14th Dist.] January 14, 1999, no pet.) (party properly initiated buy-out rights). Where a party fails to properly initiate a buy-out right under the document, it does not have such a right. *See Shadow Dance Ranch P'ship, Ltd., v. Weiner*, No. 04-03-00926-CV, 2005 Tex. App. LEXIS 10131, 2005 WL 3295664 (Tex. App.—San Antonio Dec. 7, 2005, no pet.) (court held that party's dissolution notice was not rendered ineffective because there was "no evidence that, before Gordon sent his notice of dissolution on April 26, 2001 or within sixty days of a "terminating event," Brian invoked the paragraph 6.2 [buy-out] procedures in any way.").

However, documents can be ambiguous on buy-out rights. *See Shadow Dance Ranch P'ship, Ltd., v. Weiner*, No. 04-03-00926-CV, 2005 Tex. App. LEXIS 10131, 2005 WL 3295664 (Tex. App.—San Antonio Dec. 7, 2005, no pet.) (concluding dissolution and buy out provisions in partnership agreement were ambiguous); *Donahue v. Bowles, Troy, Donahue, Johnson, Inc.*, 949 S.W.2d 746, 753 (Tex. App.—Dallas 1997, writ denied) (holding that buy-sell agreement was ambiguous because it "said nothing one way or the other about a right to reappraise the shares in light of new information" and thus made it "impossible to determine which of the two appraisals should be used to determine the value of Donahue's shares"). When a document is ambiguous, the evidence of the parties' intent should be submitted to a jury (if one is requested) so that a court can determine the document's meaning based on the jury's findings. *See Shadow Dance Ranch P'ship, Ltd., v. Weiner*, 2005 Tex. App. LEXIS 10131.

It should be noted that where an owner is also an officer, that just because the owner/officer is removed from his or her office does not ordinarily impact the owner/officer's contractual rights. Tex. Bus. Orgs. Code § 3.104(a) ("Unless otherwise provided by the governing documents of a domestic entity, an officer may be removed for or without cause by the governing authority or as provided by the governing documents of the entity. The removal of an officer does not prejudice any contract rights of the person removed."). Of course, if the relevant document provides that the removal from office impacts an owner's rights to his or her ownership shares, then the document generally controls. *Id*. Similarly, the election or appointment of an officer does not by itself create contract rights unless the relevant document states to the contrary. *Id*. at § 3.104(b).

In addition to breach of contract actions, a party can assert a claim for declaratory relief. The Uniform Declaratory Judgments Act provides that a person interested under a written contract may have determined any question of construction or validity arising under the contract and obtain a declaration of rights, status, or other legal relations under the contract. Tex. Civ. Prac. & Rem. Code Ann. § 37.004(a). Disputed issues of fact may be decided by a jury. *Id*. at § 37.007. "A declaratory judgment is appropriate only if a justiciable controversy exists as to the rights and status of the parties and the controversy will be resolved by the declaration sought." *Bonham State Bank v. Beadle*, 907 S.W.2d 465, 467, 38 Tex. Sup. Ct. J. 768 (Tex. 1995). If a declaratory judgment is appropriate, "the Declaratory Judgments Act entrusts attorney fee awards to the trial court's sound discretion, subject to the requirements that any fees awarded be reasonable and necessary, which are matters of fact, and to the additional requirements that fees be equitable and just, which are matters of law." *Bocquet v. Herring*, 972 S.W.2d 19, 21, 41 Tex. Sup. Ct. J. 650 (Tex. 1998).

B. Redemption Rights

A contractual buy-out right typically involves other owners buying the resigning owner's interest in the business. Another potential option is for the entity itself to buy back the resigning owner's interests. These redemptions rights may be set forth in a shareholder agreement. In *Skeels v. Suder*, the court held that a shareholder agreement regarding redemptions rights was enforceable even if it was inconsistent with the Business Organizations Code. No. 02-18-00112-CV, 2021 Tex. App. LEXIS 4810 (Tex. App.—Fort Worth June 17, 2021, no pet. history). "[T]he terms of any share redemption may be provided in a governing document or an applicable agreement among the members, even if the document or agreement is broader or narrower than the dictates of the BOC." *Id.* at *21. Partners of a law firm entered into a shareholder agreement that allowed certain individuals to take action. Under that power, they forcibly redeemed one shareholder's shares for zero dollars. *Id*. The court of appeals affirmed that under the various documents, it had the right to do so: "The plain language of the Resolution—a shareholder agreement—broadly allowed Friedman, Suder, and Cooke as the Firm's governing authority to take affirmative action on behalf of the Firm; thus, the trial court did not err by finding that the Resolution governed the redemption of Skeels's shares on the terms dictated by the Firm's governing authority." *Id.*

Otherwise, the Texas Business Organizations Code states:

> (a) A distribution by a corporation that involves a redemption of outstanding redeemable shares of the corporation subject to redemption may be related to any or all of those shares.
>
> (b) If less than all of the outstanding redeemable shares of a corporation subject to redemption are to be redeemed, the shares to be redeemed shall be selected for redemption: (1) in accordance with the corporation's certificate of formation; or (2) ratably or by lot in the manner prescribed by resolution of the corporation's board of directors, if the certificate of formation does not specify how shares are to be selected for redemption.
>
> (c) A redemption of redeemable shares takes effect by call and written notice of the redemption of the shares.

Tex. Orgs. Code § 21.304. The Code also has specific provisions dealing with the required notice, the deposit of money for the redemption, and the payment of redeemed shares. *Id*. at 21.305-307.

C. Dissolution Or Termination Rights

A minority owner may have the right to force the dissolution of the entity under the entity's documents. The entity's formation documents may allow for termination or dissolution upon certain circumstances coming into existence. For example, in *Shadow Dance Ranch P'ship, Ltd., v. Weiner*, partnership agreement provided: "7.1(b) "Any Partner … shall have the power to cause the dissolution of the Partnership by giving sixty (60) days prior written notice to the other Partners of said Partner's intention to dissolve the Partnership …." No. 04-03-00926-CV, 2005 Tex. App. LEXIS 10131, 2005 WL 3295664 (Tex. App.—San Antonio Dec. 7, 2005, no pet.). The limited partner sent a notice of dissolution and the majority shareholder refused to dissolve the partnership. They ended up suing each other, and the trial court ruled for the minority shareholder and held that the partnership had been dissolved and was in a liquidation phase. *Id*. The court of appeals affirmed:

> As noted above, nothing in the Agreement makes the right to call for dissolution dependent upon meeting all capital calls; nor does any provision in the Agreement make the right to call for dissolution dependent upon providing the marital addendum. And there is no direct or circumstantial evidence suggesting that the parties intended at the time they entered the Agreement to make the right to call for dissolution dependent upon either. There was thus very little evidence on the contract interpretation issue for the jury to consider. But what little evidence there is supports the jury's finding. Gordon testified that once he sent the dissolution notice, the paragraph 6.2 buy-out procedure was no longer available… Moreover, as Gordon argues, Brian's interpretation of the interplay between paragraphs 6.2 and 7.1, "taken to its logical conclusion," "would … allow Brian to ignore dissolution notices indefinitely and continue to demand capital until Gordon's ownership interest is eliminated." Brian's construction of the Agreement would thus produce an unjust, unreasonable, and oppressive result.

Id. Moreover, the court held that once notice of dissolution was provided, there was nothing else for the parties to do to effectuate it:

> Paragraph 7.1 of the Agreement provides that "any Partner … shall have the power to cause the dissolution of the Partnership by giving sixty (60) days prior written notice to the other Partners of said Partner's intention to dissolve the Partnership …." We hold this paragraph provides that dissolution was to occur on a "date certain" - sixty days after Gordon's April 26, 2001 notice of dissolution or June 25, 2001; therefore, it is irrelevant whether the remaining partners timely agreed in writing to continue the business.

Id.

The Texas Business Organization Code also provides for the termination of an entity. *See* Tex. Bus. Orgs. Code §§ 11.001-11.014. These provisions also detail a process for involuntary termination and winding up. The Code provides:

> 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).

Tex. Bus. Orgs. Code § 11.301. Section 11.303, referred to in Section 11.301, provides:

> The attorney general shall file an action against a filing entity in the name of the state seeking termination of the entity's existence if: (1) the filing entity has not cured the problems for which winding up and termination is sought before the 31st day after the date the notice under Section 11.302(b) is mailed; and (2) the attorney general determines that cause exists for the involuntary winding up of a filing entity's business and termination of the entity's existence under Section 11.301.

Id. at § 11.303. One of the potential remedies is the appointment of a receiver. *Id*. at § 11.402-414.

V. RIGHTS REGARDING STOCK

An owner's rights regarding stock ownership generally involves the right to vote. Tex. Bus. Orgs. Code § 21.152(d). However, the certificate of formation may limit or deny the voting rights of, or provide special voting rights for, the shares of a class or series or the shares of a class or series held by a person or class of persons to the extent the limitation, denial, or provision is not inconsistent with this code. Tex. Bus. Orgs. Code § 21.153(b). The certificate of formation must state the designations, preferences, limitations, and relative rights, including voting rights, of each class or series. *Id*. at § 21.153(a). Shares may also have other characteristics that provide additional rights to the owner, such as rights to distributions, convertibility, and rights in winding up the corporation. Tex. Bus. Orgs. Code § 21.154.

An owner of stock must generally provide consideration of the stock, however, the consideration can be a note payable and can be a promise to provide future services or benefits. Tex. Bus. Orgs. Code § 21.157, 21.159 (types of consideration for shares). A corporation can issue fractions of shares. *Id*. at § 21.163. "A holder of a certificated or uncertificated fractional share is entitled to exercise voting rights, receive distributions, and make a claim with respect to the assets of the corporation in the event of winding up and termination." *Id*. at § 21.164.

"A person who contemplates the acquisition of shares in a corporation may commit to act in a specified manner with respect to the shares after the acquisition, including the voting of the shares or the retention or disposition of the shares. To be binding, the commitment must be in writing and be signed by the person acquiring the shares." *Id*. at §

21.167(a). A written commitment is a contract between the shareholder and the corporation. *Id*. at § 21.167(b). Further, a corporation may grant stock rights and options, and those can include restrictions and conditions, such as limiting the transfer of the stock. *Id*. at § 21.168, 21.169.

One issue that arises is when a corporation issues additional shares to lessen an owner's percentage of shares. "A shareholder of a corporation does not have a preemptive right under this subchapter to acquire the corporation's unissued or treasury shares except to the extent provided by the corporation's certificate of formation." *Id*. at § 21.203. If the certificate of formation includes a statement that the corporation "elects to have a preemptive right" or a similar statement, Section 21.204 applies to a shareholder except to the extent the certificate of formation expressly provides otherwise. *Id*. Section 21.204 provides:

> (a) If the shareholders of a corporation have a preemptive right under this subchapter, the shareholders have a preemptive right to acquire proportional amounts of the corporation's unissued or treasury shares on the decision of the corporation's board of directors to issue the shares. The preemptive right granted under this subsection is subject to uniform terms and conditions prescribed by the board of directors to provide a fair and reasonable opportunity to exercise the preemptive right.
>
> (b) No preemptive right exists with respect to: (1) shares issued or granted as compensation to a director, officer, agent, or employee of the corporation or a subsidiary or affiliate of the corporation; (2) shares issued or granted to satisfy conversion or option rights created to provide compensation to a director, officer, agent, or employee of the corporation or a subsidiary or affiliate of the corporation; (3) shares authorized in the corporation's certificate of formation that are issued not later than the 180th day after the effective date of the corporation's formation; or (4) shares sold, issued, or granted by the corporation for consideration other than money.
>
> (c) A holder of a share of a class without general voting rights but with a preferential right to distributions of profits, income, or assets does not have a preemptive right with respect to shares of any class.
>
> (d) A holder of a share of a class with general voting rights but without preferential rights to distributions of profits, income, or assets does not have a preemptive right with respect to shares of any class with preferential rights to distributions of profits, income, or assets unless the shares with preferential rights are convertible into or carry a right to subscribe for or acquire shares without preferential rights.
>
> (e) For a one-year period after the date the shares have been offered to shareholders, shares subject to preemptive rights that are not acquired by a shareholder may be issued to a person at a consideration set by the corporation's board of directors that is not lower than the consideration set for the exercise of preemptive rights. An offer at a lower consideration or after the expiration of the period prescribed by this subsection is subject to the shareholder's preemptive rights.

Tex. Bus. Orgs. Code § 21.204. There is a restrictive period during which an owner can file suit to enforce his or her preemptive rights. *Id*. at § 21.206.

VI. MERGERS, INTEREST EXCHANGES, CONVERSIONS, AND SALES OF ASSETS

A minority owner can have his or her interests greatly impacted by a majority approving a merger, interest exchange, conversion, and/or sale of assets. The Business Organizations Code has detailed provisions regarding each of these corporate maneuvers. Tex. Bus. Orgs. Code §§ 10.001-10.350.

The Code also has provisions detailing dissenting owners' rights. The Code provides:

> (a) Subject to Subsection (b), an owner of an ownership interest in a domestic entity subject to dissenters' rights is entitled to: (1) dissent from: (A) a plan of merger to which the domestic entity is a party if owner approval is required by this code and the owner owns in the domestic entity an ownership interest that was entitled to vote on the plan of merger; (B) a sale of all or substantially all of the assets of the domestic entity if owner approval is required by this code and the owner owns in the domestic entity an ownership interest that was entitled to vote on the sale; (C) a plan of exchange in which the ownership interest of the owner is to be acquired; (D) a plan of conversion in which the domestic entity is the converting entity if owner approval is required by this code and the owner owns in the domestic entity an ownership interest that was entitled to vote on the plan of conversion; (E) a merger effected under Section 10.006 in which: (i) the owner is entitled to vote on the merger; or (ii) the ownership interest of the owner is converted or

> exchanged; (F) a merger effected under Section 21.459(c) in which the shares of the shareholders are converted or exchanged; or (G) if the owner owns shares that were entitled to vote on the amendment, an amendment to a domestic for-profit corporation's certificate of formation to: (i) add the provisions required by Section 3.007(e) to elect to be a public benefit corporation; or (ii) delete the provisions required by Section 3.007(e), which in effect cancels the corporation's election to be a public benefit corporation; and (2) subject to compliance with the procedures set forth in this subchapter, obtain the fair value of that ownership interest through an appraisal.
>
> (b) Notwithstanding Subsection (a), subject to Subsection (c), an owner may not dissent from a plan of merger or conversion in which there is a single surviving or new domestic entity or non-code organization, or from a plan of exchange, if: (1) the ownership interest, or a depository receipt in respect of the ownership interest, held by the owner: (A) in the case of a plan of merger, conversion, or exchange, other than a plan of merger pursuant to Section 21.459(c), is part of a class or series of ownership interests, or depository receipts in respect of ownership interests, that, on the record date set for purposes of determining which owners are entitled to vote on the plan of merger, conversion, or exchange, as appropriate, are either: (i) listed on a national securities exchange; or (ii) held of record by at least 2,000 owners; or (B) in the case of a plan of merger pursuant to Section 21.459(c), is part of a class or series of ownership interests, or depository receipts in respect of ownership interests, that, immediately before the date the board of directors of the corporation that issued the ownership interest held, directly or indirectly, by the owner approves the plan of merger, are either: (i) listed on a national securities exchange; or (ii) held of record by at least 2,000 owners; (2) the owner is not required by the terms of the plan of merger, conversion, or exchange, as appropriate, to accept for the owner's ownership interest any consideration that is different from the consideration to be provided to any other holder of an ownership interest of the same class or series as the ownership interest held by the owner, other than cash instead of fractional shares or interests the owner would otherwise be entitled to receive; and
>
> (3) the owner is not required by the terms of the plan of merger, conversion, or exchange, as appropriate, to accept for the owner's ownership interest any consideration other than: (A) ownership interests, or depository receipts in respect of ownership interests, of a domestic entity or non-code organization of the same general organizational type that, immediately after the effective date of the merger, conversion, or exchange, as appropriate, will be part of a class or series of ownership interests, or depository receipts in respect of ownership interests, that are: (i) listed on a national securities exchange or authorized for listing on the exchange on official notice of issuance; or (ii) held of record by at least 2,000 owners; (B) cash instead of fractional ownership interests, or fractional depository receipts in respect of ownership interests, the owner would otherwise be entitled to receive; or (C) any combination of the ownership interests, or fractional depository receipts in respect of ownership interests, and cash described by Paragraphs (A) and (B).
>
> (c) Subsection (b) shall not apply to a domestic entity that is a subsidiary with respect to a merger under Section 10.006.
>
> (d) Notwithstanding Subsection (a), an owner of an ownership interest in a domestic for-profit corporation subject to dissenters' rights may not dissent from an amendment to the corporation's certificate of formation described by Subsection (a)(1)(G) if the shares held by the owner are part of a class or series of shares, on the record date set for purposes of determining which owners are entitled to vote on the amendment: (1) listed on a national securities exchange; or (2) held of record by at least 2,000 owners.

Tex. Bus. Orgs. Code § 10.354. The Code provides for certain notice of right to dissent and appraisal. *Id*. at §§ 10.355, 10.353. The Code also details the procedures that are necessary for a party to dissent and the perfection of the right to dissent. *Id*. at § 10.356. There are very tight deadlines that must be followed in the procedure regarding a demand and what must be contained in the demand, and the dissenting owner must not consent to the transaction. *Id*. If all procedures are followed, then the dissenting owner is entitled to fair value of the ownership interests for which the rights of dissent and appraisal are sought. *Id*. A party can withdraw the demand. *Id*. at § 10.357.

If the entity receives an adequate demand, the entity must respond and accept the demand or reject same. *Id*. at § 10.358(a). If the entity accepts it, it must pay the amount in the demand if the dissenting owner returns the ownership interest. *Id*. at § 10.358(b). If the entity rejects the demand, it must "provide to the owner: (1) an estimate by the responsible organization of the fair value of the ownership interests; and (2) an offer to pay the amount of the estimate provided under Subdivision (1)." *Id*. at § 10.358(c). The dissenting owners can then accept the entity's counteroffer. *Id*. at § 10.358(d-e). If the parties cannot agree on a price, then either can file a petition requesting "a finding and determination of the fair value of the owner's ownership interests in a court in: (1) the county in which the organization's principal office is located in this state; or (2) the county in which the organization's registered office is located in this state, if the organization does not have a business office in this state." *Id.* at § 10.361(a). If done appropriately, the court will appoint appraisers to determine the fair value. *Id.* at § 10.361(e). There is no right to a jury trial in this proceeding. *Kruse v. Henderson Tex. Bancshares, Inc.,* 586 S.W.3d 118, 2019 Tex. App. LEXIS 8020 (Tex. App.—Tyler Aug. 30, 2019, no pet.).

The Code provides the following direction for the determination of the computation of fair value:

> (a) For purposes of this subchapter, the fair value of an ownership interest of a domestic entity subject to dissenters' rights is the value of the ownership interest on the date preceding the date of the action that is the subject of the appraisal. Any appreciation or depreciation in the value of the ownership interest occurring in anticipation of the proposed action or as a result of the action must be specifically excluded from the computation of the fair value of the ownership interest.
>
> (b) In computing the fair value of an ownership interest under this subchapter, consideration must be given to the value of the domestic entity as a going concern without including in the computation of value any control premium, any minority ownership discount, or any discount for lack of marketability. If the domestic entity has different classes or series of ownership interests, the relative rights and preferences of and limitations placed on the class or series of ownership interests, other than relative voting rights, held by the dissenting owner must be taken into account in the computation of value.
>
> (c) The determination of the fair value of an ownership interest made for purposes of this subchapter may not be used for purposes of making a determination of the fair value of that ownership interest for another purpose or of the fair value of another ownership interest, including for purposes of determining any minority or liquidity discount that might apply to a sale of an ownership interest.

Id. at § 10.362.

The appraisers will do an investigation and file a report with their findings on value. *Id*. at § 10.363. Either party can object to the appraisal report, and the court will then hold a hearings to determine the fair value. *Id*. at § 10.364. The court's finding is final, and the entity will immediately pay the amount in the judgment, and the dissenting owner will accept same and no longer have an interest in the entity. *Id*. The appraisers fees will be a part of court costs, and the court will assess the court costs as between the parties in a manner that the court deems s fair and equitable. *Id*. at § 10.365.

The Code also provides: "In the absence of fraud in the transaction, any right of an owner of an ownership interest to dissent from an action and obtain the fair value of the ownership interest under this subchapter is the exclusive remedy for recovery of: (1) the value of the ownership interest; or (2) money damages to the owner with respect to the action." *Id*. at § 10.368. Further, "[t]his chapter does not limit the power of a domestic entity or non-code organization to acquire all or part of the ownership or membership interests of one or more classes or series of a domestic entity through a voluntary exchange or otherwise." *Id*. at § 10.902.

VII. RIGHTS REGARDING INFORMATION

A common complaint of a minority shareholder is the denial of access to the corporation's books and records. The Texas Business Organizations Code provides the type of information that an entity shall maintain:

> (1) books and records of accounts;
>
> (2) minutes of the proceedings of the owners or members or governing authority of the filing entity and committees of the owners or members or governing authority of the filing entity;
>
> (3) a current record of the name and mailing address of each owner or member of the filing entity; and
>
> (4) other books and records as required by the title of this code governing the entity.

Tex. Bus. Orgs. Code § 3.151(a). Those records may be in written paper form or:

> maintained by or on behalf of the filing entity on, or by means of, an information storage device or method or one or more electronic data systems, provided that any books, records, minutes, and ownership or membership records so maintained can be converted into written paper form within a reasonable time.

Id. at § 3.151(b). Note that the records required by Subsection (a)(2) above "need not be maintained by a limited partnership or a limited liability company except to the extent required by its governing documents." *Id*. at § 3.151(c).

A governing person of a filing entity may examine the entity's books and records maintained under Section 3.151 and other books and records of the entity for a purpose reasonably related to the governing person's service as a governing person. Tex. Bus. Orgs. Code § 3.152(a). A court may require a filing entity to open the books and records of the filing entity, including the books and records maintained under Section 3.151, to permit a governing person to inspect, make copies of, or take extracts from the books and records on a showing by the governing person that: (1) the person is a governing person of the entity; (2) the person demanded to inspect the entity's books and records; (3) the person's purpose for inspecting the entity's books and records is reasonably related to the person's service as a governing person; and (4) the entity refused the person's good faith demand to inspect the books and records. *Id*. at § 3.152(b). A court may award a governing person attorney's fees and any other proper relief in a suit to require a filing entity to open its books and records. *Id*. at § 3.152(c). *Tex. Ear Nose & Throat Consultants, PLLC v. Jones*, 470 S.W.3d 67 (Tex. App. Houston 14th Dist. June 25, 2015, no pet.) (Texas Business Organizations Code applied to a doctor's requested access to a medical practice's records as a member and a governing person after its operative date, although he had made such requests earlier. Attorney's fees could be awarded only against the medical practice and not against individuals, and segregation of fees was required.).

Similarly, 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. Tex. Bus. Orgs. Code § 3.153. *See Davis v. Middle Bosque Partners, LP*, No. 04-13-00464-CV, 2014 Tex. App. LEXIS 3780 (Tex. App.—San Antonio Apr. 9, 2014, no pet.) (the member properly plead a declaratory relief claim when he sought a declaration of his rights to examine the books and records arising under Sections 3.151, 3.153, 1.002(22), 101.502, and 153.552).

A corporate shareholder has a right to examine corporate records and there are penalties for a violation of those rights and there are applicable defenses in an action to enforce those rights. *See* Tex. Bus. Orgs. Code §§ 21.218 (examination of records), 21.219 (annual and interim statements of corporation), 21.220 (penalty for failure to prepare voting list), 21.222 (penalty for refusal to permit examination), 21.354 (inspection of voting list), 21.372 (shareholder meeting list). Section 21.218 provides:

> On written demand stating a proper purpose, a holder of shares of a corporation for at least six months immediately preceding the holder's demand, or a holder of at least five percent of all of the outstanding shares of a corporation, is entitled to examine and copy, at a reasonable time, the corporation's books, records of account, minutes, and share transfer records relating to the stated purpose. The examination may be conducted in person or through an agent, accountant, or attorney.

Id. at § 21.218(b). This does not limit a court to order a more expanded production and inspection. *Id*. at § 21.218(c).

Section 21.222 states that a corporation is liable for failing to comply with a proper request for books and records:

> (a) A corporation that refuses to allow a person to examine and make copies of account records, minutes, and share transfer records under Section 21.218 is liable to the shareholder for any cost or expense, including attorney's fees, incurred in enforcing the shareholder's rights under Section 21.218. The liability imposed on a corporation under this subsection is in addition to any other damages or remedy afforded to the shareholder by law.

Id. at § 21.222(a). That provision goes on to provides certain defenses for a corporation, including that the owner had improperly used information in the past and was not acting in good faith and for a proper purpose:

> It is a defense to an action brought under this section that the person suing: (1) has, within the two years preceding the date the action is brought, sold or offered for sale a list of shareholders or of holders of voting trust certificates for shares of the corporation or any other corporation; (2) has aided or abetted a person in procuring a list of shareholders or of holders of voting trust certificates for the purpose described by Subdivision (1); (3) has improperly used information obtained through a prior examination

> of the books and account records, minutes, or share transfer records of the corporation or any other corporation; or (4) was not acting in good faith or for a proper purpose in making the person's request for examination.

Id. at § 21.222(b).

To assert a right to review books and records, the party asserting the right must be an owner. *JSFN, LLC v. SJ Props., LLC*, No. 10-16-00362-CV, 2018 Tex. App. LEXIS 2730 (Tex. App.—Waco Apr. 18, 2018, no pet.). To be entitled to attorney's fees for filing suit to obtain access to books and records, the owner should establish that the entity refused access to the documents. *Westerburg v. Western Royalty Corp*., No. 07-15-00082-CV, 2015 Tex. App. LEXIS 12612 (Tex. App.—Amarillo Dec. 11, 2015, no pet.). Whether an owner's shares had value established that he sought the records for a proper purpose. *Skeels v. Suder*, No. 02-18-00112-CV, 2020 Tex. App. LEXIS 7723 (Tex. App.—Fort Worth Sept. 24, 2020, op. withdrawn).

On written request of a shareholder of the corporation, a corporation shall mail to the shareholder: (1) the annual statements of the corporation for the last fiscal year that contain in reasonable detail the corporation's assets and liabilities and the results of the corporation's operations; and (2) the most recent interim statements, if any, that have been filed in a public record or other publication. Tex. Bus. Orgs. Code § 21.219.

Texas Business Organization Code Section 153.552 has similar provisions for limited partnerships. Texas Business Organization Code Section 101.502-.503 has similar provisions for limited liability companies.

VIII. RIGHTS REGARDING NOTICE OF MEETINGS AND VOTING LIST

If an officer or agent of a corporation is unable to comply with the duties because the officer or agent did not receive notice of a meeting of shareholders within a sufficient time before the date of the meeting, the corporation, rather than the officer or agent, is liable to a shareholder who suffers damages because of the failure for the extent of the damage caused by the failure. Tex. Bus. Orgs. Code § 21.221. Further, an officer or agent of a corporation who is in charge of the corporation's share transfer records and who does not prepare the list of shareholders, keep the list on file for a 10-day period, or produce and keep the list available for inspection at the annual meeting is liable to a shareholder who suffers damages because of the failure for the damage caused by the failure. *Id*. at § 21.221.

IX. RIGHTS REGARDING DIVIDENDS

Minority shareholders often complain about the failure to declare dividends, the failure to declare higher dividends, and the withholding of dividend payments after a dividend has been declared.

With regard to the failure to declare dividends and the failure to declare higher dividends, Texas statutes generally do not dictate when directors must declare dividends or how much the dividends must be. Instead, those decisions fall within the discretion of a corporation's directors (or those acting as directors). *See* Tex. Bus. Orgs. Code §§ 21.302-.303, 21.310-.313; *see also id*. §§ 21.714, 21.726-.727. The directors must make those decisions in compliance with the formal fiduciary duties that they, as officers or directors, owe to the corporation, and thus to the shareholders collectively. *See Ritchie v. Rupe*, 443 S.W.3d 856 (Tex. 2014). When directors breach their fiduciary duties by improperly withholding or failing to declare dividends, one or more shareholders can sue the directors for breach of those duties on behalf of the corporation through a derivative action. *Id*. (citing Tex. Bus. Orgs. Code §§ 21.551-.563.47).

The Texas Supreme Court first addressed this kind of a claim in the context of a closely held corporation in *Patton*. *Id*. It was a suit in which a corporation's two minority shareholders alleged that Patton—the corporation's majority shareholder, president, and controlling board member—committed fraud and breached his duties to the corporation. *Id*. The jury found that Patton had mismanaged the corporation and withheld dividends for the improper purposes of preventing the minority shareholders from sharing in the corporation's profits and depreciating the value of the corporation's stock. *Id*. The trial court appointed a receiver to liquidate the corporation. *Id*.

The Texas Supreme Court rejected the minority shareholders' mismanagement claims, but recognized that the finding that Patton had used "his control of the board for the malicious purpose of . . . preventing dividends and otherwise lowering the value . . . of the stock of the [minority shareholders], is something else." *Id*. The Court equated this finding with a "breach of trust for which the courts will afford a remedy," and the Court treated that claim as being brought by the shareholders on behalf of the corporation. *Id*. The Court determined that the appropriate remedy in that circumstance was an injunction order compelling payment of the dividends. *Id*.

When a corporate director violates the duty to act solely for the benefit of the corporation and refuses to declare dividends for some other, improper purpose, the director breaches fiduciary duties to the corporation, and the minority shareholders are entitled to relief, either directly to the corporation or through a derivative action. *Id.* If, on the other hand, 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 shareholders.

As the Court said in *Ritchie*:

> In sum, a remedy exists for dividend decisions made in violation of a director's duties to the corporation and its shareholders collectively, but no remedy exists for decisions that comply with those duties, even if they result in incidental harm to a minority shareholder's individual interests. But even when a corporate controller's dividend decision itself does not give rise to a remedy, that is not typically the end of the inquiry. Allegations that directors or controlling shareholders are manipulating dividends to "oppress" minority shareholders typically arise when the accused not only withhold dividends but also use some method to distribute the corporation's profits exclusively to themselves—frequently, by inflating their own salaries. As discussed below, when corporate controllers misappropriate corporate funds for their own use or pay themselves excessive salaries out of corporate coffers, they do so in violation of their fiduciary duty to the corporation, and the law affords a remedy for that misconduct.

Id.

Moreover, shareholders have a right to receive payment of a declared dividend in accordance with the terms of the shares and the corporation's certificate of formation, and they can enforce that right as a debt against the corporation. *See, e.g., Cavitt v. Amsler,* 242 S.W. 246, 247 (Tex. Civ. App.—Austin 1922, writ dism'd) ("[W]hen a dividend is declared, it becomes a debt owing by the corporation to the stockholders.").

X. RIGHT TO EMPLOYMENT

Minority shareholders also complain when the majority terminates their employment with the corporation. A minority shareholder's loss of employment with a corporation can be particularly harmful because a job and its salary are often the sole means by which shareholders receive a return on their investment in the corporation.

Texas is steadfastly an at-will employment state. "For well over a century, the general rule in this State, as in most American jurisdictions, has been that absent a specific agreement to the contrary, employment may be terminated by the employer or the employee at will, for good cause, bad cause, or no cause at all." *Montgomery Cnty. Hosp. Dist. v. Brown,* 965 S.W.2d 501, 502 (Tex. 1998). The Texas Supreme Court has consistently recognized that it benefits both employees, by allowing them to change employers freely as they deem best, and employers, by allowing them to make employment decision as they deem best, without second-guessing by courts and juries. *See, e.g., Marsh USA Inc. v. Coo*k, 354 S.W.3d 764, 776 (Tex. 2011) ("A person's right to use his own labor in any lawful employment is . . . one of the first and highest of civil rights."); *Chevron Corp. v. Redmon*, 745 S.W.2d 314, 318 (Tex. 1987) ("Employers should have the right and the freedom to make their employment decisions without interference unless they discriminate against some protected group which might otherwise be unfairly denied employment.").

Although at-will employment is the default, employers and employees have the freedom to contract for a different employment relationship. *See* Tex. Bus. Orgs. Code § 2.101(5). In fact, the Business Organizations Code expressly permits corporate shareholders to memorialize the terms of employment for a director, officer, or other employee in a shareholders' agreement. *Id*. §§ 21.101(a)(4), 21.714(b)(9). In the absence of such a contract, however, the company and its shareholders do not give up their at-will employment rights. *Cf. Tex. Farm Bureau Mut. Ins. Cos. v. Sears*, 84 S.W.3d 604, 608 (Tex. 2002) ("At-will employment is an important and long-standing doctrine in Texas, and we have been reluctant to impose new common-law duties that would alter or conflict with the at-will relationship." (citations omitted)).

There may be situations in which, despite the absence of an employment agreement, termination of a key employee is improper, for no legitimate business purpose, intended to benefit the directors or individual shareholders at the expense of the minority shareholder, and harmful to the corporation. *See Ritchie v. Rupe,* 443 S.W.3d 856 (Tex. 2014). "Though the ultimate determination will depend on the facts of a given case, such a decision could violate the directors' fiduciary duties to exercise their "uncorrupted business judgment for the sole benefit of the corporation" and to refrain from "usurp[ing] corporate opportunities for personal gain."" *Id*. A shareholder may enforce these duties through a derivative action. *Id*. Such actions could potentially be "oppressive" and justify the appointment of a rehabilitative receiver. *Id*.

XI. RIGHTS REGARDING THE MISAPPLICATION OF CORPORATE FUNDS AND DIVERSION OF CORPORATE OPPORTUNITIES

Minority shareholders also complain about the majority misapplying corporate funds and assets and diverting corporate opportunities. The duty of loyalty that officers and directors owe to the corporation specifically prohibits them from misapplying corporate assets for their personal gain or wrongfully diverting corporate opportunities to themselves. *Id*. These types of actions may be redressed through a derivative action, or through a direct action brought by the corporation, for breach of fiduciary duty. *Id*. (citing *Wingate v. Hajdik*, 795 S.W.2d 717, 719 (Tex. 1999) (holding that sole shareholder could recover on behalf of company, but not in individual capacity, for former shareholder and officer's misappropriation of corporate assets)). Further, a shareholder may potentially sue directly for a rehabilitative receivership. *Id*. Fiduciary duties are discussed in more detail below.

XII. RIGHTS REGARDING THE MANIPULATION OF STOCK VALUES

Minority shareholders also complain about the directors' manipulation of the value of the corporation's stock. Controlling shareholders or directors of a corporation may seek to artificially deflate the shares' value to allow the company or its shareholders to purchase a minority shareholder's shares for less than their true market value or to hinder a minority shareholder's sale of shares to third parties. The directors' fiduciary duties to the corporation provide protection for minority shareholders affected by such conduct when the conduct harms them in their capacity as shareholders. *Id*. These types of actions may be redressed through a derivative action, or through a direct action brought by the corporation, for breach of fiduciary duty. *Id*. Fiduciary duties are discussed in more detail below.

XIII. RIGHTS REGARDING GOVERNANCE OF BUSINESS

A business's controlling documents usually define how the business will be run and who will run it. "Subject to the [Business Organizations Code] and the governing documents of the domestic entity, the governing authority of a domestic entity manages and directs the business and affairs of the domestic entity." Tex. Bus. Orgs. Code § 3.101. There are provisions for governance of an entity during an emergency. *Id*. at § 3.251. "[A]n emergency exists if a majority of a domestic entity's governing persons cannot readily participate in a meeting because of the occurrence of a catastrophic event." *Id*.

Regarding a minority owners' right to participate in governance, the Texas Organization Code has provisions on the location of ownership meetings (Section 6.001), notice of meetings (Section 6.051), record dates (Section 6.101), the voting of ownership interests (Section 6.151), written consent (Section 6.201), and voting trusts and voting agreements (Section 6.251).

XIV. RIGHTS REGARDING THE FALSE FILING OF INSTRUMENTS

A person has to file certain instruments to create a business in Texas. "Filing instrument" means "an instrument, document, consent, or statement that is required or authorized by this code to be filed by or for an entity with the filing officer in accordance with Chapter 4." Tex. Bus. Orgs. Code § 1.002(23). "A filing instrument must be: (1) signed by a person authorized by this code to act on behalf of the entity in regard to the filing instrument; and (2) delivered to the secretary of state in person or by mail, courier, facsimile or electronic transmission, or any other comparable form of delivery." *Id*. at 4.001(a). If a filing instrument is false, a party may have claim regarding the filing of same:

> (a) A person may recover damages, court costs, and reasonable attorney's fees if the person incurs a loss and: (1) the loss is caused by a: (A) forged filing instrument; or (B) filed filing instrument that constitutes an offense under Section 4.008; or (2) the person reasonably relies on: (A) a false statement of material fact in a filed filing instrument; or (B) the omission in a filed filing instrument of a material fact required by this code to be included in the instrument.
> (b) A person may recover under Subsection (a) from: (1) each person who forged the forged filing instrument or signed the filing instrument and knew when the instrument was signed of the false statement or omission; (2) any managerial official of the entity who directed the signing and filing of the filing instrument who knew or should have known when the instrument was signed or filed of the false statement or omission; or (3) the entity that authorizes the filing of the filing instrument.

Id. at § 4.007. A person also commits a criminal offense by signing or directing that an instrument be filed that is materially false. *Id*. at § 4.008.

XV. RIGHTS REGARDING ULTRA VIRES ACTS

The Texas Organizations Code has an express provision where a shareholder can sue to enjoin an ultra vires act:

> (c) The fact that an act or transfer is beyond the scope of the expressed purpose or purposes of the corporation or is inconsistent with an expressed limitation on the authority of an officer or director may

> be asserted in a proceeding: (1) by a shareholder or member against the corporation to enjoin the performance of an act or the transfer of property by or to the corporation; (2) by the corporation, acting directly or through a receiver, trustee, or other legal representative, or through members in a representative suit, against an officer or director or former officer or director of the corporation for exceeding that person's authority; or (3) by the attorney general to: (A) terminate the corporation; (B) enjoin the corporation from performing an unauthorized act; or (C) enforce divestment of real property acquired or held contrary to the laws of this state.
>
> (d) If the unauthorized act or transfer sought to be enjoined under Subsection (c)(1) is being or is to be performed or made under a contract to which the corporation is a party and if each party to the contract is a party to the proceeding, the court may set aside and enjoin the performance of the contract. The court may award to the corporation or to another party to the contract, as appropriate, compensation for loss or damage resulting from the action of the court in setting aside and enjoining the performance of the contract, excluding loss of anticipated profits.

Tex. Bus. Orgs. Code § 20.002(c). *See Carmichael v. Tarantino Props.*, 604 S.W.3d 469 (Tex. App.—Houston [14th Dist.] June 4, 2020, no pet.) (condominium owners had derivative claims that the officers breached fiduciary duties to the association by committing ultra vires acts encompassed by the statute).

XVI. SHAREHOLDER DERIVATIVE SUITS

A. General Rules

The general rule in Texas is that "individual stockholders have no separate and independent right of action for injuries suffered by the corporation which merely result in the depreciation of the value of their stock." *Perry v. Cohen*, 285 S.W.3d 137, 144 (Tex. App.—Austin 2009, pet. denied) (quoting *Wingate v. Hajdik*, 795 S.W.2d 717, 719 (Tex. 1990)). "Accordingly, an action for such injury must be brought by the corporation, not individual shareholders." *Id.*; *see also AON Props., Inc. v. Riveraine Corp.*, No. 14-96-00229-CV,1999 Tex. App. LEXIS 199, 1999 WL 12739 (Tex. App.—Houston [14th Dist.] January 14, 1999, no pet.) (Generally, limited partners cannot sue individually for wrongs done to the partnership). In derivative proceedings, "'the controversy is between the corporation and the fraudulently acting officers and directors. It (the corporation) is really the complainant in the suit . . . .'" *Tex. Soc'y, Daughters of The Am. Revolution, Inc. v. Fort Bend Chapter, The Nat'l Soc'y of the Am. Revolution*, 590 S.W.2d 156, 160 (Tex. App.—Texarkana 1979, writ ref'd n.r.e.).

A stockholder's derivative suit is "an action in which the individual shareholder steps into the shoes of the corporation and usurps the board of directors' authority to decide whether to pursue the corporation's claims." *In re Crown Castle Int'l Corp.*, 247 S.W.3d 349, 355 (Tex. App.—Houston [14th Dist.] 2008, no pet.). "The derivative action developed in equity to enable shareholders to sue in the corporation's name where those in control of the company refused to assert a claim belonging to it." *Moody v. Nat'l W. Life Ins. Co.*, No. 01-18-01106-CV, 2020 Tex. App. LEXIS 9649 (Tex. App.—Houston [1st Dist.] Dec. 10, 2020, no pet.). Because a derivative suit "impinges on the managerial freedom of directors," a stockholder's right to pursue a derivative suit is "limited to situations where either the stockholder has demanded the directors pursue a corporate claim and the directors have wrongfully refused to do so, or where demand is excused because the directors are incapable of making an impartial decision regarding whether to institute such litigation." *Id.*

Before a shareholder can institute a derivative action, he or she must send a written demand to the corporation regarding the complained of conduct. "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." Tex. Bus. Orgs. Code § 21.553. However, the waiting period before a derivative proceeding "may be instituted is not required or, if applicable, shall terminate if: (1) the shareholder has been 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." *Id*.

After a corporation receives a demand, it must fairly consider it. The Business Organizations Code provides:

> (a) A determination of how to proceed on allegations made in a demand or petition relating to a derivative proceeding must be made by an affirmative vote of the majority of: (1) all independent and disinterested directors of the corporation, regardless of whether the independent and disinterested directors constitute a quorum of the board of directors; (2) a committee consisting of one or more independent and disinterested directors appointed by an affirmative vote of the majority of one or more independent and disinterested directors, regardless of whether the independent and disinterested directors constitute a quorum of the

> board of directors; or (3) a panel of one or more independent and disinterested individuals appointed by the court on a motion by the corporation listing the names of the individuals to be appointed and stating that, to the best of the corporation's knowledge, the individuals to be appointed are disinterested and qualified to make the determinations contemplated by Section 21.558.
>
> (b) The court shall appoint a panel under Subsection (a)(3) if the court finds that the individuals recommended by the corporation are independent and disinterested and are otherwise qualified with respect to expertise, experience, independent judgment, and other factors considered appropriate by the court under the circumstances to make the determinations. An individual appointed by the court to a panel under this section may not be held liable to the corporation or the corporation's shareholders for an action taken or omission made by the individual in that capacity, except for an act or omission constituting fraud or wilful misconduct.

Tex. Bus. Orgs. Code § 21.544. The demand tolls the statute of limitations. *Id*. at § 21.557.

A district court can potentially dismiss the derivative proceeding if the corporation files a motion that the derivative proceeding is not in the corporation's best interest:

> (a) A court, sitting in equity as the finder of fact, shall dismiss a derivative proceeding on a motion by the corporation if the person or group of persons described by Section 21.554 determines in good faith, after conducting a reasonable inquiry and based 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.
>
> (b) In determining whether the requirements of Subsection (a) have been met, the burden of proof shall be on: (1) the plaintiff shareholder if: (A) the majority of the board of directors consists of independent and disinterested directors at the time the determination is made; (B) the determination is made by a panel of one or more independent and disinterested persons appointed under Section 21.554(a)(3); or (C) the corporation presents prima facie evidence that demonstrates that the applicable person or persons making the determination under Section 21.554(a) are independent and disinterested; or (2) the corporation in any other circumstance.

Tex. Bus. Orgs. Code § 21.558. *See In re Life Partners Holdings, Inc.*, No. DR-11-C-43-AM, 2015 U.S. Dist. LEXIS 168198, 2015 WL 8523103 (W.D. Tex. Nov. 9, 2015) (court dismissed case after committee's finding that suit should not continue).

If the corporation commences an inquiry into the allegations, a court may stay the derivative proceeding:

> (a) If the corporation that is the subject of a derivative proceeding commences an inquiry into the allegations made in a demand or petition and the person or group of persons described by Section 21.554 is conducting an active review of the allegations in good faith, the court shall stay a derivative proceeding for not more than 60 days until the review is completed and a determination is made by the person or group regarding what further action, if any, should be taken.
> (b) To obtain a stay, the corporation must provide the court with a written statement agreeing to advise the court and the shareholder making the demand of the determination promptly on the completion of the review of the matter.
>
> (c) A stay, on motion, may be reviewed every 60 days for continuation of the stay if the corporation provides the court and the shareholder with a written statement of the status of the review and the reasons why an extension for a period not to exceed 60 additional days is appropriate. An extension shall be granted for a period not to exceed 60 days if the court determines that the continuation is appropriate in the interests of the corporation.

Tex. Bus. Orgs. Code § 21.555.

There is a limitation on discovery if the corporation proposes to dismiss the derivative proceeding:

> (a) If a corporation proposes to dismiss a derivative proceeding under Section 21.558, discovery by a shareholder after the filing of the derivative proceeding in accordance with this subchapter shall be limited to: (1) facts relating to whether the person or persons described by Section 21.554 are independent and

> disinterested; (2) the good faith of the inquiry and review by the person or group; and (3) the reasonableness of the procedures followed by the person or group in conducting the review.
>
> (b) Discovery described by Subsection (a) may not be expanded to include a fact or substantive matter regarding the act, omission, or other matter that is the subject matter of the derivative proceeding but the scope of discovery shall not be so limited if the court determines after notice and hearing that a good faith review of the allegations has not been made by an independent and disinterested person or group in accordance with Sections 21.554 and 21.558.

Tex. Bus. Orgs. Code § 21.556. *See also In re Platinum Energy Solutions, Inc.*, 420 S.W.3d 342, 2014 Tex. App. LEXIS 22 (Tex. App.—Houston [14th Dist.] Jan. 2, 2014, no pet.).

"If a derivative proceeding is instituted after a demand is rejected, the petition must allege with particularity facts that establish that the rejection was not made in accordance with the requirements and standards under Sections 21.554 and 21.558." Tex. Bus. Orgs. Code § 21.559. Further, "A derivative proceeding may not be discontinued or settled without court approval," and "the court shall direct that notice be given to the affected shareholders if the court determines that a proposed discontinuance or settlement may substantially affect the interests of other shareholders." Tex. Bus. Orgs. Code § 21.560.

The court also has the power to award fees and costs to the winning party:

> On termination of a derivative proceeding, the court may order: (1) the corporation to pay expenses the plaintiff incurred in the proceeding if the court finds the proceeding has resulted in a substantial benefit to the corporation; (2) the plaintiff to pay expenses the corporation or other defendant incurred in investigating and defending the proceeding if the court finds the proceeding has been instituted or maintained without reasonable cause or for an improper purpose; or (3) a party to pay expenses incurred by another party relating to the filing of a pleading, motion, or other paper if the court finds the pleading, motion, or other paper: (A) was not well grounded in fact after reasonable inquiry; (B) was not warranted by existing law or a good faith argument for the application, extension, modification, or reversal of existing law; or (C) was interposed for an improper purpose, such as to harass, cause unnecessary delay, or cause a needless increase in the cost of litigation.

Tex. Bus. Orgs. Code § 21.561(b). "Expenses" means "reasonable expenses incurred by a party in a derivative proceeding, including: (1) attorney's fees; (2) costs in pursuing an investigation of the matter that was the subject of the derivative proceeding; or (3) expenses for which the corporation may be required to indemnify another person." *Id.* at § 21.561(a). *See, e.g., Moody v. Nat'l W. Life Ins. Co.*, No. 01-18-01106-CV, 2020 Tex. App. LEXIS 9649 (Tex. App.—Houston [1st Dist.] Dec. 10, 2020, no pet.) (court affirmed award against shareholder). *J.C. Penney Co. v. Ozenne*, 453 S.W.3d 509 (Tex. App.—Dallas 2014, pet. denied) (affirmed award for the shareholder).

Regarding standing to bring a derivative claim, 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 originating 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." Tex. Bus. Orgs. Code § 21.552. "Shareholder" includes "a shareholder as defined by Section 1.002 or a beneficial owner whose shares are held in a voting trust or by a nominee on the beneficial owner's behalf." *Id.* at § 21.551(2). For example, in one case a court held that neither a husband nor a wife had standing to bring derivative action against a corporation's management with respect to its decision on the dividends to be paid to the shareholders, where neither the husband nor the wife owned stock in the corporation although the wife was the income beneficiary of a trust that owned stock in the corporation. *Cleaver v. Cleaver*, 935 S.W.2d 491 (Tex. App.—Tyler Nov. 27, 1996, no writ). *See also Neff ex rel. Weatherford Int'l, Ltd. v. Brady*, 527 S.W.3d 511 (Tex. App.—Houston [1st Dist.] June 29, 2017, no pet.).

Regarding foreign corporations, "in a derivative proceeding brought in the right of a foreign corporation, the matters covered by this subchapter are governed by the laws of the jurisdiction of formation of the foreign corporation, except for Sections 21.555, 21.560, and 21.561, which are procedural provisions and do not relate to the internal affairs of the foreign corporation, unless applying the laws of the jurisdiction of formation of the foreign corporation requires otherwise with respect to Section 21.555." Tex. Bus. Orgs. Code § 21.562. "In the case of matters relating to a foreign corporation under Section 21.555, a reference to a person or group of persons described by Section 21.554 refers to a person or group entitled under the laws of the jurisdiction of formation of the foreign corporation to make the determination described by Section 21.554(a). The standard of review of a determination made by the person or group shall be governed by the laws of the jurisdiction of formation of the foreign corporation." *Id*. *See also In re Crown Castle Int'l Corp*., 247 S.W.3d 349 (Tex. App.—Houston [14th Dist.] Jan. 29, 2008, no pet.).

B. Closely Held Entities

The legislature has enacted special provisions allowing shareholders of closely-held corporations and limited liability companies to more easily bring a derivative suit on behalf of the company (note that there are different rules for limited partnerships). Unlike the general rules for derivative litigation, which are extremely anti-shareholder, the alternatively procedure for closely-held corporations is substantially more shareholder-friendly. Under Section 21.563, there is no demand requirement before filing suit, there is no contemporaneous ownership requirement, there is no requirement of adequate representation, and a court may allow direct recovery by the plaintiff.

A "closely held corporation" means "a corporation that has: (1) fewer than 35 shareholders; and (2) 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." Tex. Bus. Orgs. Code § 21.563. The Code provides:

> (b) Sections 21.552-21.560 do not apply to a claim or a derivative proceeding by a shareholder of a closely held corporation against a director, officer, or shareholder of the corporation. In the event the claim or derivative proceeding is also made against a person who is not that director, officer, or shareholder, this subsection applies only to the claim or derivative proceeding against the director, officer, or shareholder.
>
> (c) If Sections 21.552-21.560 do not apply because of Subsection (b) and if justice requires: (1) a derivative proceeding brought by a shareholder of a closely held corporation may be treated by a court as a direct action brought by the shareholder for the shareholder's own benefit; and (2) a recovery in a direct or derivative proceeding by a shareholder may be paid directly to the plaintiff or to the corporation if necessary to protect the interests of creditors or other shareholders of the corporation.
>
> (d) Other provisions of state law govern whether a shareholder has a direct cause of action or right to sue a director, officer, or shareholder, and this section may not be construed to create that direct cause of action or right to sue.

Id.

When a shareholder brings a derivative action on behalf of a closely held corporation, however, the trial court may treat the derivative action as a direct action brought by the shareholder for his own benefit and award recovery directly to the shareholder "if justice requires." Tex. Bus. Orgs. Code § 21.563(c); *Sneed v. Webre*, 465 S.W.3d 169, 181 (Tex. 2015). This is contrary to the common law that a shareholder cannot recover personally for damages incurred by a corporation of which he is a shareholder. *Wingate v. Hajdik*, 795 S.W.2d 717 (Tex. 1990) ("[a] corporate stockholder cannot recover damages personally for a wrong done solely to the corporation, even though he may be injured by that wrong."). Where the evidence shows that the corporation was a closely held corporation and that the plaintiff was a shareholder, a trial court is authorized to treat the derivative claims as individual claims because "a recovery in a direct or derivative proceeding by a shareholder may be paid directly to the plaintiff or to the corporation if necessary to protect the interests of creditors or other shareholders of the corporation." Tex. Bus. Orgs. Code § 21.563(c); *Saden v. Smith*, 415 S.W.3d 450 (Tex. App.—Houston [1st Dist.] 2013, no pet.); *Swank v. Cunningham*, 258 S.W.3d 647, 665 (Tex. App.—Eastland 2008, pet. denied).

For example, in *Al-Wahban v. Hamdan*, the defendant challenged the shareholder's standing to sue and obtain a temporary injunction against the company. No. 10-19-00026-CV, 2019 Tex. App. LEXIS 4849 (Tex. App.—Waco June 12, 2019, no pet.). The court stated:

> Yousuf brought this lawsuit derivatively as a shareholder of Hanis Texas Tires 19, Inc. d/b/a Texas Tires of Waco.—a closely-held corporation that has fewer than thirty-five shareholders and is not listed or regularly quoted on any national securities exchange or over-the-counter market. Therefore, in accordance with Texas case law and section 21.563(c) of the Business Organizations Code, Yousuf, as an alleged shareholder of Hanis Texas Tires 19, Inc., is permitted to bring a derivative action on behalf of the corporation, and the trial court could treat the derivative action as a direct action brought by Yousuf for his own benefit.

Id.

The current provision relating to limited liability companies gives a trial court discretion to treat "a derivative proceeding brought by a member of a closely held limited liability company . . . as a direct action brought by the member for the member's own benefit" and to order "a recovery in a direct or derivative proceeding by a member [to be] paid directly to the plaintiff or to the limited liability company if necessary to protect the interests of creditors or other members of the limited liability company." Bus. Orgs. § 101.463(c). A closely-held limited liability company is defined as a company with less 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." *Id*. at § 101.463(a).

As the *Sneed* court explained when discussing the predecessor to section 21.563: "[T]here is not an absolute right for a shareholder [of a closely held corporation] to recover directly for claims based on corporate injuries. Rather, if justice requires, a court may treat a derivative proceeding like a direct action and allow the shareholder to recover directly." 465 S.W.3d at 188 (emphasis added). Courts have recognized that the decision whether justice requires the shareholder to recover directly under this statute is a matter left to the trial court's discretion. *See Guajardo v. Hitt*, 562 S.W.3d 768 (Tex. App.—Houston [14th Dist.] 2018, pet. denied); *Saden v. Smith*, 415 S.W.3d 450, 463-65 (Tex. App.—Houston [1st Dist.] 2013, pet. denied) (holding that trial court was authorized to permit shareholder of closely held corporation to recover damages for breach of fiduciary duty owed to corporation when shareholder met statutory requirements); *Swank v. Cunningham,* 258 S.W.3d 647, 665 (Tex. App.—Eastland 2008, pet. denied) ("[U]nder Section 21.563(c), the trial court has discretion to award damages in a derivative proceeding directly to the shareholder."); *see also Cardwell v. Gurley*, No. 05-09-01068-CV, 2018 Tex. App. LEXIS 5460, 2018 WL 3454800, at *6 (Tex. App.—Dallas July 18, 2018, no pet.) (mem. op.) (holding that similarly worded statute applicable to a closely held limited liability company "gives a trial court discretion" to allow a member of such company to recover directly (citing Bus. Orgs. Code § 101.463(c))).

In *Guajardo*, the court affirmed the trial court's refusal to allow an LLC member to recover the company's damages directly:

> we cannot say the trial court abused its discretion by refusing Guajardo's request that he personally recover for BDS's damages resulting from Chesnutt and Hitt's breaches of their fiduciary duties to BDS. In this case, Guajardo was one of four shareholders, each of whom was entitled to 25% of the corporation's earnings; Guajardo argued different wrongful actions done by different shareholders; and only two of the shareholders were found to have damaged the corporation. Guajardo cites no case in which section 21.563(c) has been applied in such a situation to require the recovery to be paid to "the only [innocent] one." We therefore overrule Guajardo's first and second issues as to his breach of fiduciary duty claims.

562 W.3d at 781.

XVII. AVAILABILITY OF RECEIVERSHIP RELIEF IN CLOSELY-HELD BUSINESS DISPUTES

A. Introduction

As stated previously in this article, the Texas Supreme Court in *Ritchie v. Rupe,* held that there was no claim for shareholder oppression in Texas because there was a potential receivership remedy. 443 S.W.3d 856 (Tex. 2014). Generally, there are three types of receiverships. The first type is a receiver that takes possession and control over specific property. So, for example, such a receiver may take possession of the inventory of a car dealership. The second type of receivership involves a receiver managing an entity to rehabilitate it for the period of time. The receiver takes the business out of the hands and management of the current managers and operates it for the benefit of all concerned. The object of this type of receivership is to manage an entity to preserve its operations and value until the court determines who should be operating the business. The third type of receivership is a receivership to liquidate an entity. This type of receivership is similar to a bankruptcy proceeding where the receiver collects and liquidates the entity's assets, pays claims, debts, and expenses, and then pays the remaining funds, if any, to the owners as directed by the court. These three types of receiverships have different scopes and purposes.

One key to a successful receivership is the selection of a qualified and disinterested receiver. A receiver is an "officer of the court, the medium through which the court acts. He is a disinterested party, the representative and protector of the interests of all persons, including creditors, shareholders and others, in the property in receivership." *Akin, Gump, Strauss, Hauer and Feld, L.L.P. v. E-Court, Inc*., No. 03-02-00714-CV,2003 Tex. App. LEXIS 3966, 2003 WL 21025030 (Tex. App.—Austin May 8, 2003, no pet.) (quoting *Security Trust Co. of Austin v. Lipscomb County*, 142 Tex. 572, 180 S.W.2d 151, 158 (Tex. 1944)). Even though the court appoints the receiver, the party seeking the receivership will normally make suggestions on the identity of the receiver to the court. Accordingly, a party seeking a receivership should be very careful in the selection of the receiver for the receivership.

B. What Law Governs?

The first step is to determine what law applies for an application for a receivership. If the entity is a domestic entity, then the only avenue for a receivership is the Texas Business Organizations Code. "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 set forth in this code." Tex. Bus. Orgs. Code § 11.401. *See also Spiritas v. Davidoff*, 459 S.W.3d 224 (Tex. App.—Dallas Feb. 27, 2015, no pet.). "Domestic entity" is defined for purposes of business organizations code as "an organization formed under or the internal affairs of which are governed by this code." Tex. Bus. Orgs. Code § 1.002(18). For a foreign entity, a party can use the Texas Business Organizations Code and may also use the Texas Civil Practice and Remedies Code.

C. Where To File?

For a domestic entity, if the plaintiff wants to obtain a receivership over specific property (not the business generally), then the plaintiff should file suit in any court that has jurisdiction over that property. Tex. Bus. Orgs. Code §11.402(a). Otherwise, if a plaintiff wants a receivership over the entire entity, then the case should be filed in the district court in the county in which the registered office or principal place of business of a domestic entity is located. Tex. Bus. Orgs. Code §11.402(b). *See also In re Estate of Hallmark*, No. 11-18-00187-CV 2020 Tex. App. LEXIS 7063 (Tex. App.—Eastland August 31, 2020, no pet. history) (probate court did not have jurisdiction to enter rehabilitative receivership).

D. What Are The Standards For A Receivership Over Specific Property Owned By A Domestic Entity?

The Texas Business Organizations Code provides that court can issue a receivership for specific property held by a domestic or foreign entity 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.

Tex. Bus. Orgs. Code §11.403.

For example, a trial court did not abuse its discretion in appointing a receiver to take control of property that a plaintiff believed secured a note because the record supported the trial court's findings that the plaintiff was a creditor and had a probable interest in or right to the property, and the record supported the finding that the property was in danger of being lost, removed, or materially injured. *Dayton Reavis Corp. v. Rampart Capital Corp.*, 968 S.W.2d 529 (Tex. App.—Waco 1998, pet. dism'd w.o.j.). In *Spiritas v. Davidoff*, the court held that a receivership order could not be supported under Section 11.403 as the trial court did not appoint the receiver for "specific property." 459 S.W.3d 224, 235 (Tex. App.—Dallas Feb. 27, 2015, no pet.).

E. What Are The Standards For A Receivership To Rehabilitate A Domestic Entity?

The Texas Business Organizations Code provides that court can issue a receivership to rehabilitate a domestic entity 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 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: (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.

Tex. Bus. Orgs. Code §11.404.

Section 11.404 is not limited to closely held corporations. *Ritchie v. Rupe*, 443 S.W.3d 856 (Tex. 2014). The Legislature has adopted a single standard for rehabilitative receivership based on oppressive actions that applies to all corporations (and, under the current statute, any "domestic entity") without regard to the number of its shareholders or the marketability of its shares." *Id*.

One of the more common grounds under this statute is for "oppressive" conduct. The Texas Supreme Court stated:

> Dictionary definitions of "oppression" include "[t]he act or an instance of unjustly exercising authority or power," "[c]oercion to enter into an illegal contract," and—reflective of case law addressing claims like Rupe's claim in this case—"[u]nfair treatment of minority shareholders (esp. in a close corporation) by the directors or those in control of the corporation." Black's Law Dictionary 1203 (9th ed. 2009). As these definitions and the Legislature's other uses of the term demonstrate, "oppressive" is a broad term that can mean different things in different contexts. Under the other statutes, a government regulation, a subpoena, the amount of bail, the use of military or official authority, a franchise agreement, and a debt collector's actions can all be "oppressive." Generally, these statutes indicate that "oppressive" actions involve an abuse of power that harms the rights or interests of another person or persons and disserves the purpose for which the power is authorized.

Ritchie v. Rupe, 443 S.W.3d 856 (Tex. 2014). The Court held that directors or managers engage in oppressive actions when they abuse their authority over the corporation with the intent to harm shareholder interests, 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. *Ritchie v. Rupe*, 443 S.W.3d 856 (Tex. 2014). Absent such evidence, directors do not act oppressively in refusing to meet with potential buyers of a minority shareholder's stock. *Id*.

In a case involving the oppressive conduct of a majority shareholder, the Texas Supreme Court held that Texas law did not authorize a buy-out order as a remedy; a claim for shareholder oppression was only available through a statute, and the only remedy available under that statute was a rehabilitative receivership. *Cardiac Perfusion Servs. v. Hughes*, 436 S.W.3d 790 (Tex. 2014). The Court held that a minority shareholder in a closely held corporation could have recovered equitable relief through a derivative action for breach of fiduciary duties, and a remand was appropriate in the interest of justice to determine whether the minority shareholder was able to pursue such a claim. *Id. See also Mandel v. Thrasher (In re Mandel)*, 578 Fed. Appx. 376, 2014 U.S. App. LEXIS 15709 (5th Cir. Tex. 2014) (Bankruptcy court should not have awarded plaintiffs compensatory damages on the shareholder oppression claim because the Supreme Court of Texas made clear that Tex. Bus. Orgs. Code Ann. § 11.404 creates a single cause of action with a single remedy and that remedy is not the award of compensatory damages but the appointment of a rehabilitative receiver.).

In *Spiritas v. Davidoff*, the court held that the receiver under Section 11.404(a)(1)(B) was not possible as there was not sufficient evidence of irreparable harm. 459 S.W.3d 224 (Tex. App.—Dallas Feb. 27, 2015, no pet.).

In Xr-5, LP v. Margolis, the court affirmed in part and reversed in a part an order appointing a receiver under Section 11.404. No. 02-10-00290-CV, 2011 Tex. App. LEXIS 2181 (Tex. App.—Fort Worth March 24, 2011, no pet.). Regarding the entity, the court affirmed, holding: "The evidence shows ongoing mismanagement of XR-5's funds and business affairs, the existence of J&M's lien (though not specified in detail), J&M's pending lawsuit against XR-5 for repossession of a pump and monies owed, and Express's lien against XR-5 for $28,212.85." *Id*. Regarding a property's owner, the court reversed, holding: "Appellees' evidence—the three affidavits—fails to show that the land was in imminent danger of foreclosure and that a receivership over Skull Creek was necessary to protect Appellees' interest in the well." *Id.*

In *Fortenberry v. Cavanaugh*, the court reversed a rehabilitative receivership where there were other adequate remedies. No. 03-04-00816-CV, 2005 Tex. App. LEXIS 4665, 2005 WL 1412103 (Tex. App.—Austin June 16, 2005, no pet.).

In *Robinson v. Thompson*, there was ample evidence showing a waste and misapplication of the assets of the corporation that supported a receivership order. 466 S.W.2d 626 (Tex. Civ. App.—Eastland 1971, no writ). The evidence shows that the president of the corporation and other salaried personnel who were receiving salaries monthly in advance were performing no worthwhile work for the corporation, and that actually nothing was being done for the benefit of the corporation; that all of the assets of the corporation with the exception of its office furniture and a small amount of oil field equipment have been disposed of; that the corporation was spending about $1,100 per month and had no income, and that the operating budget would have completely dissipated current assets of the corporation within a couple of months; that the corporation has no properties to develop, no money with which to develop them, and nothing in the way of assets in Australia except some office furniture. *Id*. There was ample evidence in support of the finding that the president of the corporation was conducting ruinous business policies which would result in insolvency if continued. *Id*.

In *Citizens Bldg., Inc. v. Azios*, the court affirmed a receivership order. 590 S.W.2d 569, 572 (Tex. Civ. App.—Houston [14th Dist.] 1979, writ ref'd n.r.e.). The evidence showed that the corporation had paid no rent under its lease with the Trust, that there were disputes among the directors as to what debts the corporation owed, there were disputes as to the rightful president, bookkeeper, collection agent and official depository of the corporation. *Id*. This evidence when considered together with the evidence of the personal animosity existing between the owners, would support a finding by the court that the corporation was in imminent danger of insolvency. *Id*. Even though the obligations of the corporation were being satisfied by the shareholders in some instances, the obligations remain those of the corporation. The ramifications of the failure of the corporation to meet its obligations were apparent to the trial court. *Id*.

In *Alert Synteks, Inc. v. Jerry Spencer, L.P.*, the court held that the trial court erred in entering a receivership order:

> To iterate, among the requirements that must be met before a trial court can appoint a receiver under Section 7.04 is that the trial court determine that other remedies available either at law or in equity are inadequate. See TEX. BUS. CORP. ACT § 7.04(A); *see also Associated Bankers Credit Co. v. Meis,* 456 S.W.2d 744, 750 (Tex. Civ. App.-Corpus Christi 1970, no writ) (under Section 7.04, a receiver will not be appointed if the status of the property can be maintained and the rights of the applicant protected pending a hearing by the issuance of a restraining order or temporary injunction, or by any remedy less drastic than a receivership).
>
> In the case at hand, Spencer offered no evidence at the hearing on its motion to appoint a receiver to support the trial court's finding that other remedies available either at law or in equity were inadequate. No evidence of record supports that other methods which could potentially be employed to trace the missing funds, such as traditional discovery, had been attempted and failed or were otherwise unavailable. In fact,

> there is no indication in the record that any discovery had been attempted at the time the trial court granted Spencer's motion. Moreover, the record is silent as to reasons why injunctive relief could not be employed to preserve assets or why monetary damages would not provide an adequate remedy. We hold that by granting Spencer's motion to appoint a receiver where there was no evidence supporting its finding that other remedies available either at law or in equity were inadequate, the trial court abused its discretion.

151 W.3d 246, 253(Tex. App.—Tyler 2004, no pet.).

F. What Are The Standards For A Receivership To Liquidate A Domestic Entity?

The Texas Business Organizations Code provides that court can issue a receivership to liquidate a domestic 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: (1) when an action has been filed by the attorney general under this chapter to terminate the existence of the entity and it is established that liquidation of the entity's business and affairs should precede the entry of a decree of termination; (2) on application of the entity to have its liquidation continued under the supervision of the court; (3) if the entity is in receivership and the court does not find that any plan presented before the first anniversary of the date the receiver was appointed is feasible for remedying the condition requiring appointment of the receiver; (4) on application of a creditor of the entity if it is established that irreparable damage will ensue to the unsecured creditors of the domestic entity as a class, generally, unless there is an immediate liquidation of the property of the domestic entity; or (5) on application of a member or director of a nonprofit corporation or cooperative association and it appears the entity is unable to carry out its purposes.
>
> (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.

Tex. Bus. Orgs. Code §11.405.

Trial court's order appointing a receiver for a corporation's assets in order to determine whether to liquidate was affirmed because the appointment statute was not unconstitutional and did not violate the trial court's equity jurisdiction. *Aubin v. Territorial Mortg. Co.,* 640 S.W.2d 737, 1982 Tex. App. LEXIS 4971 (Tex. App.—Houston [14th Dist.] Aug. 19, 1982, no writ).

Before a trial court can order a liquidating receiver, the applicant must plead and prove the right to obtain that relief. In one case, the trial court's order liquidating a corporation lacked statutory authority because there was no application by a creditor, no action by the Attorney General, and the corporation did not request dissolution. *Kaspar v. Thorne*, 755 S.W.2d 151 (Tex. App.—Dallas 1988, no writ).

In another case, the court affirmed the order where the order winding up a joint venture did not violate Texas Business Organizations Code Section 152.701(1) because (1) the statute did not require the joint venture's continuation pending the completion of executory contracts, (2) the order took the joint venture's early lease termination liability, (3) nothing showed a wind-up representative would gain personally, and (4) Tex. Bus. Orgs. Code Ann. § 11.405(b)(3) did not apply. *CBIF Ltd. P'ship v. TGI Friday's Inc.,* No. 05-15-00157-CV, 2016 Tex. App. LEXIS 12844 (Tex. App.—Dallas Dec. 5, 2016), *op. withdrawn, sub. op., vacated,* No. 05-15-00157-CV, 2017 Tex. App. LEXIS 3605 (Tex. App.—Dallas Apr. 21, 2017, no pet.).

In *Spiritas v. Davidoff*, the court held that an order appointing a receiver was not supported by Section 11.405 as there was not sufficient evidence of irreparable damage. 459 S.W.3d 224, 235 (Tex. App.—Dallas Feb. 27, 2015, no pet.). The court stated:

> We concluded above the record does not show that at the time of the order in question, the trial court had before it any evidence of an "irreparable injury" being "suffered" or "threatened." See id. § 11.404(a)(1)(B). The parties do not address whether "irreparable damage" is distinguishable from "irreparable injury" and we have found no authority to support any difference between those terms. *Cf. Fite v. Emtel, Inc.*, No. 01-07-00273-CV, 2008 Tex. App. LEXIS 7343, 2008 WL 4427676, at *5 (Tex. App.—Houston [1st Dist.] Oct. 2, 2008, pet. denied) (mem. op.) (using terms "irreparable injury" and "irreparable damage" without distinction in analysis of whether evidence supported appointment of receiver under predecessor to section 11.404). Accordingly, we conclude the record does not show any evidence, at the time of the order in question, of "irreparable damage" that "will ensue."

Id.

G. What Are the Standards For A Receivership Of A Foreign Entity?

A party can seek a receivership over a foreign entity under the Texas Business Organizations Code, which has been previously discussed. Also, in the alternative, a party can seek a receivership over a foreign entity under the Texas Civil Practice and Remedies Code. Section 64.001 of the Texas Civil Practice and Remedies Code provides:

> (a) A court of competent jurisdiction may appoint a receiver: (1) in an action by a vendor to vacate a fraudulent purchase of property; (2) in an action by a creditor to subject any property or fund to his claim; (3) in an action between partners or others jointly owning or interested in any property or fund; (4) in an action by a mortgagee for the foreclosure of the mortgage and sale of the mortgaged property; (5) for a corporation that is insolvent, is in imminent danger of insolvency, has been dissolved, or has forfeited its corporate rights; or (6) in any other case in which a receiver may be appointed under the rules of equity.
>
> (b) Under Subsection (a)(1), (2), or (3), the receiver may be appointed on the application of the plaintiff in the action or another party. The party must have a probable interest in or right to the property or fund, and the property or fund must be in danger of being lost, removed, or materially injured.
>
> (c) Under Subsection (a)(4), the court may appoint a receiver only if:(1) it appears that the mortgaged property is in danger of being lost, removed, or materially injured; or (2) the condition of the mortgage has not been performed and the property is probably insufficient to discharge the mortgage debt.
>
> (d) A court having family law jurisdiction or a probate court located in the county in which a missing person, as defined by Article 63.001, Code of Criminal Procedure, resides or, if the missing person is not a resident of this state, located in the county in which the majority of the property of a missing person's estate is located may, on the court's own motion or on the application of an interested party, appoint a receiver for the missing person if: (1) it appears that the estate of the missing person is in danger of injury, loss, or waste; and (2) the estate of the missing person is in need of a representative.

Tex. Civ. Prac. & Rem. Code Ann. § 64.001.

Under Subsection (a)(1), (2), or (3), the receiver may be appointed on the application of the plaintiff in the action or another party. *Id*. at § 64.001(b). The party must have a probable interest in or right to the property or fund, and the property or fund must be in danger of being lost, removed, or materially injured. *Id*.

Under Subsection (a)(2), the term "creditor" does not mean any creditor, but a secured creditor. In *Jay & VMK. Corp. v. Lopez*, the court held that the trial court erred in granting a receivership to a buyer seeking to recover earnest money from a corporation because the buyer did not have a security interest in the corporation's property as required by Tex. Civ. Prac. & Rem. Code Ann. § 64.001(a)(2). 572 S.W.3d 698 (Tex. App.—Houston [14th Dist.] Jan. 24, 2019, no pet.). The court stated: "Since this provision was construed in Carter, it has been 'uniformly held that a creditor, to be entitled to a receivership, must be a secured creditor.' A receivership is authorized only as to the specific property or funds to which the lien extends." *Id*.

Section 64.001(a)(3) provides the court may appoint a receiver in an action between parties jointly interested in any property." *Hawkins v. Twin Montana, Inc.*, 810 S.W.2d 441, 444 (Tex. App.—Fort Worth 1991, no writ). Prior to the appointment of a receiver under subsection (a)(3), the trial court must find that the party seeking appointment of the receiver has "a probable interest in or right to the property or fund, and the property or fund must be in danger of being lost, removed, or materially injured." Tex. Civ. Prac. & Rem. Code Ann. § 64.001(b); *In re Estate of Martinez*, NO. 01-18-00217-CV, 2019 Tex. App. LEXIS 2614 (Tex. App.—Houston [1st Dist.] April 2, 2019, no pet.) (reversed receivership in estate case where there was no evidence that property was in danger of being lost, removed, or materially injured). However, the plaintiff does not have to plead or prove that the defendant is insolvent, which is a normal requirement for an equitable receivership. *Hawkins v. Twin Montana, Inc.*, 810 S.W.2d 441, 444 (Tex. App.—Fort Worth 1991, no writ).

Under Subsection (a)(4), the court may appoint a receiver only if: (1) it appears that the mortgaged property is in danger of being lost, removed, or materially injured; or (2) the condition of the mortgage has not been performed and the property is probably insufficient to discharge the mortgage debt. Tex. Civ. Prac. & Rem. Code § 64.001(c).

A court may not appoint a receiver for a corporation, partnership, or individual on the petition of the same corporation, partnership, or individual. Tex. Civ. Prac. & Rem. Code § 64.002(a). A court may appoint a receiver for a corporation on the petition of one or more stockholders of the corporation. *Id*. at § 64.002(b). This section does not prohibit: (1) appointment of a receiver for a partnership in an action arising between partners; or (2) appointment of a receiver over all or part of the marital estate in a suit filed under Title 1 or 5, Family Code. *Id*. at § 64.002(c). Courts have upheld the appointment of a receiver under this statute. *A-Medical Advantage Healthcare Sys., Associated v. Shwarts*, No. 10-18-00050-CV, 2019 Tex. App. LEXIS 11278 (Tex. App.—Waco Dec. 31, 2019, no pet.*); In re Estate of Trevino*, No. 04-05-00202-CV, 2005 Tex. App. LEXIS 6827 (Tex. App. San Antonio Aug. 24, 2005), op. withdrawn, sub. op., 195 S.W.3d 223, 2006 Tex. App. LEXIS 1201 (Tex. App.—San Antonio Feb. 15, 2006) (danger of business being lost); *Dayton Reavis Corp. v. Rampart Capital Corp*., 968 S.W.2d 529 (Tex. App.—Waco Apr. 29, 1998, pet. dism'd w.o.j.); *Smith v. Smith*, 681 S.W.2d 793 (Tex. App.—Houston [14th Dist.] Oct. 18, 1984, no writ) (partner's conduct placed partnership property in jeopardy); *Robinson v. Thompson*, 466 S.W.2d 626 (Tex. Civ. App.—Eastland 1971, no writ) (corporation was wasting assets); *Ellman v. Reinarz*, 390 S.W.2d 519 (Tex. Civ. App.—Austin May 5, 1965, pet. dism'd w.o.j.) (company was insolvent).

Under Subsection (a)(6), a "court of competent jurisdiction may appoint a receiver" in any case "in which a receiver may be appointed under the rules of equity." Tex. Civ. Prac. & Rem. Code § 64.001(a)(6). Courts have affirmed receivership orders under this provision. *A-Medical Advantage Healthcare Sys., Associated v. Shwarts*, No. 10-18-00050-CV, 2019 Tex. App. LEXIS 11278 (Tex. App.—Waco Dec. 31, 2019); *Pajooh v. Royal W. Invs. LLC*, 518 S.W.3d 557, 2017 Tex. App. LEXIS 2759 (Tex. App.—Houston [1st Dist.] Mar. 30, 2017, no pet.); *In re Estate of Trevino*, 195 S.W.3d 223 (Tex. App.—San Antonio 2006, no pet.); *In re Estate of Herring*, 983 S.W.2d 61 (Tex. App.—Corpus Christi 1998 no pet.), *But see In re Estate of Martinez*, No. 01-18-00217-CV, 2019 Tex. App. LEXIS 2614 (Tex. App.—Houston [1st Dist.] April 2, 2019, no pet.); *Genssler v. Harris County*, 584 S.W.3d 1 (Tex. App.—Houston [1st Dist.] Oct. 7, 2010, no pet.) (equity did not allow trial court to institute a liquidating receivership). In equity, an applicant should show a right to, or interest in, the property or fund in litigation or show at least a probable right or interest in either. *Continental Homes Co. v. Hilltown Property Owners Ass'n, Inc.*, 529 S.W.2d 293 (Tex. Civ. App.—Fort Worth 1975); *Pelton v. First Nat. Bank of Angleton*, 400 S.W.2d 398 (Tex. Civ. App.—Houston 1966, no writ); Wadsworth v. Cole, 265 S.W.2d 628 (Tex. Civ. App.—El Paso 1954). An applicant must show that the property or fund in litigation is in danger of being lost, removed, or materially injured. *B & W Cattle Co. v. First Nat. Bank of Hereford*, 692 S.W.2d 946 (Tex. App.—Amarillo 1985); *Smith v. Smith*, 681 S.W.2d 793 (Tex. App.—Houston [14th Dist.] 1984, no writ); *Rubin v. Gilmore*, 561 S.W.2d 231 (Tex. Civ. App.—Houston [1st Dist.] 1977, no writ). An applicant must show that there is some advantage from the appointment as equity does not do vain thing. *Grandfalls Mut. Irr. Co. v. White*, 62 Tex. Civ. App. 182, 131 S.W. 233 (1910); *Simpson v. Alexander*, 188 S.W. 285 (Tex. Civ. App.—Austin 1916); *Bounds v. Stephenson*, 187 S.W. 1031 (Tex. Civ. App.—Dallas 1916 writ ref'd).

An applicant must show that another remedy does not exist at law or in equity. *Trevino v. Starr County*, 660 S.W.2d 140 (Tex. App.—San Antonio 1983, writ dism); *Robinson v. Thompson*, 466 S.W.2d 626 (Tex. Civ. App.—Eastland 1971, no writ); *Pfeiffer v. Pfeiffer*, 394 S.W.2d 679 (Tex. Civ. App.—Houston 1965, writ dism.). Otherwise stated, an applicant must show that there is a necessity for the receivership in order to have an equitable receivership. *Pouya v. Zapa Interests, Inc.*, No. 03-07-00059-CV, 2007 Tex. App. LEXIS 7243, 2007 WL 2462001 (Tex. App.—Austin Aug. 13, 2007, no pet.); *Whitson Co. v. Bluff Creek Oil Co.*, 256 S.W.2d 1012, 1015 (Tex. Civ. App.—Fort Worth 1953, writ dism'd w.o.j.). In equity, the claim for a receiver must be ancillary to an independent cause of action. *Pelton v. First Nat'l Bank of Angleton*, 400 S.W.2d 398, 401 (Tex. Civ. App.—Houston 1966, no writ). A party cannot solely seek an equitable receivership. Although insolvency of the owner or the one in possession of a fund or property in controversy is usually an important element bearing on the necessity and propriety of appointing a receiver, not every case of receivership according to the usage of the court of equity depends on a showing of insolvency. *Dillingham v. Putnam*, 109 Tex. 1, 14 S.W. 303 (1890); *Duncan v. Thompson*, 25 S.W.2d 634 (Tex. Civ. App.—Dallas 1930); Rische v. Rische, 46 Tex. Civ. App. 23, 101 S.W. 849 (1907, writ dism.); *Richardson v. McCloskey*, 228 S.W. 323 (Tex. Civ. App.—Austin 1920, writ dismissed w.o.j.).

H. Conclusion

Parties in closely-held business disputes, i.e., business divorce, may need to seek receivership relief to preserve the value of the business or its assets. When that time comes, the party should consider what type of receivership is necessary, what law controls the request, what court will be the appropriate court to file in, and what evidence will be necessary to establish the required elements for the sought-after receivership. A pre-trial receivership is a very valuable remedy that can preserve the substance of a plaintiff's claims. It places an independent third party in charge of managing the business or its assets. There are many benefits to a receivership when a business or its assets are mismanaging, wasting, or otherwise misappropriated. However, it is an extreme remedy that takes a party's business out of its hands and places it into the hands of another. For these reasons, courts should carefully balance the parties' interests in awarding such relief.

XVIII. CLOSE CORPORATION RIGHTS

The Business Organizations Code permits corporations to declare themselves to be "close corporations," which allows them to take advantage of two subchapters of the Code dedicated to the special needs of such corporations and exempts them from many of the rules that govern other types of corporations. *See* Tex. Bus. Orgs. Code §§ 21.701-.732 (subchapter O, Close Corporations), 21.751-.763 (subchapter P, Judicial Proceedings Relating to Close Corporations). In addition to the judicial proceedings that other corporate shareholders can bring, shareholders in close corporations are authorized to institute proceedings to enforce a close corporation provision, appoint a provisional director, or appoint a custodian. *Id*. § 21.752. 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. *Id*. § 21.756. And the Legislature has afforded businesses that elect to operate as close corporations even greater contractual liberty. *See generally* Tex. Bus. Orgs. Code §§ 1.001 et seq.; *id.* § 21.701-.732.

Even when a closely held corporation does not elect to operate as a "close corporation," the Legislature has enacted special rules to allow its shareholders to more easily bring a derivative suit on behalf of the corporation. Tex. Bus. Orgs. Code § 21.563. Shareholders in a closely held corporation, for example, can bring a derivative action without having to prove that they "fairly and adequately represents the interests of" the corporation, *id*. § 21.552(2), 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. *See id.* §§ 21.563(b), 21.553-55, 21.558-59. And when justice requires, the court may treat a derivative action on behalf of a closely held corporation "as a direct action brought by the shareholder for the shareholder's own benefit," and award any recovery directly to that shareholder. *See id.* § 21.563(c).

XIX. FIDUCIARY DUTIES

Fiduciary litigation is an important part of any business divorce conflict. A minority shareholder should understand his or her rights regarding the majority owner's fiduciary obligations. A "fiduciary" is a "person who occupies a position of peculiar confidence towards another." *Kinzbach Tool Co. v. Corbett-Wallace Corp.*, 138 Tex. 565, 571, 160 S.W.2d 509, 512 (1942). Certain formal relationships, such as that between an attorney and a client or between a trustee and the trust's beneficiaries, give rise to a fiduciary relationship as a matter of law. *Johnson v. Brewer & Pritchard, P.C.*, 73 S.W.3d 193, 199 (Tex. 2002). Texas law recognizes different kinds of fiduciary duties owed under different circumstances. *See, e.g.*, *Meyer v. Cathey*, 167 S.W.3d 327, 330-31 (Tex. 2005) (discussing formal and informal fiduciary duties); *Paddock v. Siemoneit*, 218 S.W.2d 428 (Tex. 1949) ("Acts which might well be considered breaches of trust as to other fiduciaries have not always been so regarded in cases of corporate officers or directors.").

If a party breaches a fiduciary duty, there can be serious consequences. The breach of a fiduciary duty is a tort and can result in the award of actual damages (even mental anguish), exemplary/punitive damages, disgorgement relief, forfeiture relief, injunctions, receiverships, rescission, accounting, constructive trust, equitable liens, maybe attorney's fees, and other relief. *See, e.g., David F. Johnson, Remedies for Breach of Fiduciary Duty Claims in Texas*, State Bar of Texas, Fiduciary Litigation Course, 2020. There can be criminal consequences for misapplication of fiduciary property and other similar types of crimes. So, compliance with those duties is very important.

A. FIDUCIARY DUTIES

1. Officers and Directors

Corporate officers and directors have fiduciary duties to their company. Directors are typically responsible for overseeing the company, attending board meetings, and promoting the best interests of the company. Corporate officers, including the president, vice president, secretary and treasurer, manage the day-to-day operations of the company.

As a fiduciary an officer owes a strict duty of good faith and candor and is prohibited from using the relationship to benefit his personal interests without the principal's full knowledge and consent. *See, e.g., Cardwell v. Gurley*, No.

05-09-01068-CV,2018 Tex. App. LEXIS 5460, 2018 WL 3454800, at *4-5(Tex. App.—Dallas July 18, 2018, pet. denied); *Lowry v. Tarbox*, 537 S.W.3d 599, 615 (Tex. App.—San Antonio 2017, pet. denied); *Loy v. Harter*, 128 S.W.3d 397, (Tex. App.—Texarkana 2004, pet. denied) (citing *International Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 577 (Tex. 1963) (duty of loyalty requires "extreme measure of candor, unselfishness, and good faith[,]" and, as fiduciaries, corporate directors are "under obligation not to usurp corporate opportunities for personal gain," and must dedicate "uncorrupted business judgment for the sole benefit of the corporation")). Officers and directors owe the following general fiduciary duties:

> A duty to not usurp corporate opportunities for personal gains, to use the utmost good faith in the relations with the corporation, to fully disclose all matters affecting the corporation (including any personal interest the officer or director has in the subject matter of a contract the officer or director is negotiating with the corporation), to be loyal, to use uncorrupted business judgment for the sole benefit of the corporation.

Sneed v. Webre, 465 S.W.3d 169, 178 (Tex. 2015); *International Banks Life Ins. v. Holloway*, 368, S.W.2d 567, 577 (Tex. 1967). *See also Bohatch v. Bulter & Binion*, 977 S.W.2d 543, 545 (Tex. 1998) (duty of loyalty and good faith); *International Bankers Life Ins. v. Holloway*, 368 S.W.2d at 576 (duty to not compete); *Duncan v. Woodlawn Mfg.*, No. 08-14-00025-CV, 2015 Tex. App. LEXIS 6085 (Tex. App.—El Paso June 17, 2015, no pet) (duty of loyalty, honesty, good faith, candor); *General Dynamics v. Torres*, 915 S.W.2d 45, 49 (Tex. App.—El Paso 1995, writ denied) (duty of loyalty and full disclosure); *Veale v. Rose*, 657 S.W.2d 834, 837 (Tex. App.—Corpus Christi 1983, writ ref'd n.r.e) (duty to not compete); *Gearhart Indus., Inc. v. Smith Int'l, Inc.*, 741 F.2d 707, 719 (5th Cir. 1984) (duty of obedience). Importantly, the "duty of loyalty dictates that a corporate officer or director must act in good faith and must not allow his or her personal interest to prevail over the interest of the corporation." *Loy v. Harter*, 128 S.W.3d 397, 407 (Tex. App.—Texarkana 2004, pet. denied). A duty of loyalty is described as requiring an extreme measure of candor, unselfishness, and good faith on the part of the officer or director. *Holloway,* 368 S.W.2d at 577; *Landon v. S & H Mktg. Grp., Inc.*, 82 S.W.3d 666, 672 (Tex. App.—Eastland 2002, no pet.). The classic breach of loyalty is self-dealing: the director or his surrogate uses his board seat to transact business with the corporation on unfair terms or to poach a business opportunity that belongs to the corporation by right. *Int'l Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 576-78 (Tex. 1963); *Icom Sys., Inc. v. Davies,* 990 S.W.2d 408, 410 (Tex. App.—Texarkana 1999, no pet.).

Further, though not mentioned among the big three fiduciary duties of care, loyalty, and obedience, there is a statutory duty to exercise reasonable oversight over the corporation and its affairs. *In re Life Partners Holdings, Inc.*, No. DR-11-C-43-AM, 2015 U.S. Dist. LEXIS 168198, 2015 WL 8523103 (W.D. Tex. Nov. 9, 2015). Section 21.401(a)(1) of the Texas Business Organizations Code grants the board of directors alone the right to run the business or to authorize corporate officers to run it for them. But delegating managerial authority does not relieve the board of its duty under § 21.401(a)(2) to monitor the corporation. In the standard division of labor at a public company, the board of directors "oversees the corporation, which operates through officers that report to the board." *Ritchie v. Rupe*, 443 S.W.3d 856, 893 (Tex. 2014) (citing TBOC § 21.401(a)). "Texas courts, like other jurisdictions, do not apply the business judgment rule in cases . . . [of] 'an obvious and prolonged failure to exercise oversight or supervision.' *Roth v. Mims*, 298 B.R. 272, 282-83 (N.D. Tex. 2003) (quoting *Resolution Trust Corp. v. Acton*, 844 F.Supp. 307, 314 (N.D. Tex. 1994)). Thus, it has been held that "[i]f a director willfully or through complete inattention ignores obvious signs of employee wrongdoing, the law will 'cast the burden of liability upon him.'" *Resolution Trust Corp. v. Norris*, 830 F. Supp. 351, 357 (S.D. Tex. 1993) (interpreting Texas law, though citing *Graham v. Allis-Chalmers Mfg. Co*., 41 Del. Ch. 78, 188 A.2d 125, 130 (Del. 1963)). A director acts in good faith when he "act[s] with an intent to confer benefit on the corporation." *Gearhart*, 741 F.2d at 720 (citing Int'l Bankers, 368 S.W.2d at 578). When a disinterested director becomes uninterested in the problems facing the corporation and sits on his hands, he acts in bad faith. So when a director fails to act for the benefit of the corporation under circumstances in which an affirmative duty—the duty to monitor—requires such action, and does so with conscious disregard for that obligation, he breaches his duty of loyalty. As one court stated:

> There are two situations in which a board consciously disregards its oversight responsibilities and thereby subjects itself to liability for the wrongdoing of other corporate agents. The first is where directors had no notice of the wrongdoing because they "utterly failed" to implement or "consciously failed" to oversee a sound monitoring system, "thus disabling themselves from being informed of risks or problems requiring their attention." Id. at 370. Examples include audit committee members not regularly attending their meetings and the corporation lacking an audit committee altogether. *Rich ex rel. Fuqi Int'l, Inc. v. Yu Kwai Chong,* 66 A.3d 963, 981 (Del. Ch. 2013). The second is where directors have been alerted to, but refuse to address, a red flag—an obvious sign of possible wrongdoing that requires further investigation and,

> potentially, corrective action. *Wood v. Baum*, 953 A.2d 136, 143 (Del. 2008); South, 62 A.3d at 15. For example, an audit committee acts in bad faith if it "possessed knowledge of facts suggesting potential accounting improprieties . . . and took no action to respond to them." *Guttman v. Huang*, 823 A.2d 492, 507 (Del. Ch. 2003). Central to both kinds of misconduct is that "the directors knew that they were not discharging their fiduciary obligations," and therefore acted in bad faith. *Stone*, 911 A.2d at 370; *Wood*, 953 A.2d at 141.

In re Life Partners Holdings, Inc., No. DR-11-C-43-AM, 2015 U.S. Dist. LEXIS 168198, 2015 WL 8523103 (W.D. Tex. Nov. 9, 2015).

A director's duty of care typically means that the director has to: (1) be informed and educated with respect to their decision-making obligations; (2) devote attention to matters; and (3) form a "reasonable belief" about matters. The duty to become informed requires a director to become sufficiently familiar with background facts and circumstances relating to a particular issue before taking action. The process typically involves directors reviewing written materials provided before or at a board meeting and paying attention to or participating in the deliberation leading up to a vote on a particular matter.

There is also a duty of obedience. *Id*. The duty of obedience (not the duty of loyalty) requires "a director to avoid committing 'illegal acts.'" Benson, 867 F. Supp. at 522 (quoting Gearhart, 741 F.2d at 719). If a disinterested director approves a corporate act that violates positive law with "actual knowledge" of its illegality, he is liable for breach of fiduciary duty, which, as a "knowing violation of law," cannot be exculpated. Tex. Bus. Orgs. Code § 7.001(c)(2)(B); *F.D.I.C. v. Benson*, 867 F. Supp. 512, 522 (S.D. Tex. 1994); *Resolution Trust Corp. v. Norris,* 830 F. Supp. 351, 357 (S.D. Tex. 1993). In practice, the scienter requirement makes such claims very difficult to prove.

For example, in *Corley v. Hendricks*, three individuals (Gaylen, Dan, and Corley) operated a business as shareholders, officers, and directors. No. 02-16-00293-CV, 2017 Tex. App. LEXIS 3846 (Tex. App.—Fort Worth April 27, 2017, pet. denied). Galen then terminated Corley and removed him as an officer and director. Corley then sued the other two for breach of fiduciary duty, theft under the TTLA, fraud, and civil conspiracy, as well as a shareholder's derivative action under Texas Business Organizations Code Section 21.563. During the course of discovery, an expert learned that Gaylen had moved $2.4 million from a retained earnings account to Gaylen's personal account and did other inappropriate activities such as pay for family vacations from the business. Galen and Dan filed a no-evidence summary judgment motion on Corley's theft claim under the TTLA, asserting that there was no evidence that they acted without consent. They argued that because Gaylen and Dan were officers and directors at the time of Gaylen's actions, her actions had the effective consent of the company. The trial court granted the defendants' motion for summary judgment, and the plaintiff appealed.

The court of appeals reversed, holding that Gaylen and Dan could not give consent to the improper transactions because they were interested directors and officers. "Interested directors and shareholders cannot give effective consent to breaching their fiduciary duty to the company by stealing from the company at the expense of other directors and shareholders." *Id*. The court held:

> In Corley's affidavit attached to his summary judgment response, he stated that he did not know and was not told about the transactions in which the Hendrickses allegedly stole funds from SSBI. Corley could not consent to transactions he knew nothing about. Corley thus presented the trial court with more than a scintilla of summary judgment evidence that he—the only disinterested director and shareholder—had not consented to the transactions. See Tex. Bus. Orgs. Code Ann. § 21.418(b)(1) (providing that a transaction involving an interested director is valid if the material facts as to the director's interest in the transaction are disclosed and the transaction is approved by the majority of disinterested directors or by a good faith vote by the shareholders).
>
> The Hendrickses' only summary judgment ground relied on their ability to consent to the transactions, which, as a matter of law, they could not do. Because the Hendrickses could not consent to their own theft, and because Corley produced evidence that he did not consent to the transactions, Corley produced evidence raising a fact issue about whether SSBI had consented to the transactions.

Id. The court reversed the summary judgment and remanded the case for further proceedings in the trial court.

Further, "A corporation's financial inability to take advantage of a corporate opportunity and the corporation's abandonment of a business opportunity are two defenses to a suit alleging usurpation of a corporate opportunity." *BCOWW Holdings, LLC v. Collins*, No. SA-17-CA-00379-FB, 2017 U.S. Dist. LEXIS 142618 (W.D. Tex. September 5, 2017).

Corporate officers owe fiduciary duties to the corporation. *See Hoggett v. Brown*, 971 S.W.2d 472, 488 (Tex. App.—Houston [14th Dist.] 1997, pet. denied); *Int'l Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 577 (Tex. 1963) (stating that a corporate fiduciary owes a duty of loyalty and "is under obligation not to usurp corporate opportunities for personal gain"). Traditionally, a corporate officer owes a fiduciary duty to the shareholders collectively, i.e., the corporation, but he does not occupy a fiduciary relationship with an individual shareholder unless some contract or special relationship exists between them in addition to the corporate relationship. *See Ritchie v. Rupe*, 443 S.W.3d 856, n. 27 (Tex. 2014); *Myer v. Cuevas*, 119 S.W.3d 830, 836 (Tex. App.—San Antonio 2003, no pet.); *Faour v. Faour*, 789 S.W.2d 620, 621-22 (Tex. App—Texarkana 1990, writ denied) (citing *Kaspar v. Thorne*, 755 S.W.2d 151, 155 (Tex. App.—Dallas 1988, no writ)).

However, there is authority that an officer or directly may plan to leave and negotiate with another company without breaching fiduciary duties. In *Great American Food Chain, Inc. v. Andreottola*, a corporate officer and director negotiated and accepted employment with a competitor while still employed with his prior employer. No. 3:14-CV-1727-BK, 2016 U.S. Dist. LEXIS 27658 (N.D. Tex. March 4, 2016). After the officer terminated his employment, the prior employer sued based on multiple claims. One claim asserted by the prior employer was that the defendant breached a fiduciary duty as officer and director. The former employer argued that a fiduciary duty encompasses, at minimum, a duty of good faith and fair dealing, and it requires one to place the interest of the other party before his own as well as a duty not to compete with the principal in matters relating to the subject matter of their transactions. The former employer argued that the defendant was required to provide notice of his intent to terminate his position, and he wrongfully breached his fiduciary duty when he accepted employment with the competitor while still engaged as a president and director. The court disagreed, holding that the prior employer's arguments fell short. The court noted that the Supreme Court of Texas had observed that such actions do not constitute breach of fiduciary duty by an employee. Moreover, the court also noted that there was no evidence in the record to suggest that the defendant misappropriated trade secrets, impermissibly solicited its customers, improperly used its funds for personal gain or otherwise attempted to injure his prior employer. *Id*.

However, an officer or directly cannot actively compete before they leave. For example, in *E&E Serv. & Supply v. Ruddick*, a corporation sued a former employee/officer/director who formed a competing business. No. 11-14-00055-CV, 2016 Tex. App. LEXIS 7514 (Tex. App.—Eastland July 14, 2016, no pet. history). The trial court granted summary judgment for the employee based on the alleged absence of any evidence of a fiduciary duty. The court of appeals reversed because the employee had served as an officer and director of the corporation in 2008, and, under corporate bylaws, may have continued to serve during the operable time period because, although she was not reappointed as a director, the bylaws provided that a director would continue to serve until a replacement was appointed and a replacement was not appointed until after the relevant time period. The court concluded: "At a minimum, the summary judgment evidence raises a fact question that Ruddick continued to serve as a director or as an officer until her successor was appointed in April 2011. Thus, the trial court erred when it granted summary judgment with respect to whether or not Ruddick owed a fiduciary duty based upon her status as a director and officer of E & E." *Id*.

In *Rex Performance Prods., LLC v. Tate*, a company sued its former officers for breaching fiduciary duties related to the sale of the company's assets. No. 02-20-00009-CV, 2020 Tex. App. LEXIS 10465 (Tex. App.—Fort Worth December 31, 2020, no pet.). The company alleged that the officers intentionally drove down the price of the sale in order to obtain a separate bonus from the buyer. The defendants alleged that the plaintiff knew of the side bonus agreement and consummated the transaction anyway, thereby establishing a waiver or ratification. The trial court granted summary judgment for the defendants, and the plaintiff appealed.

The court of appeals discussed the fiduciary duties owed by officers and directors:

> Corporate officers and directors owe a fiduciary duty to the corporation that they serve. A corporate fiduciary is under an obligation not to usurp corporate opportunities for personal gain, and equity will hold him accountable to the corporation for his profits if he does so. The responsibility of the corporate fiduciary includes the dedication of his uncorrupted business judgment for the sole benefit of the corporation. As this court has noted before, it is without question that corporate officers and fiduciaries are "held 'in official action, to the extreme measure of candor, unselfishness, and good faith.'" The duty of loyalty dictates that a corporate officer or director must act in good faith and must not allow his personal interest to prevail over that of the corporation. Directors and officers of a corporation must make full disclosure of their personal interest in a transaction that they are negotiating for the corporation. A transaction in which a corporate fiduciary derives personal profit is subject to the closest examination, and the form of the transaction will give way to the substance of what actually occurred.

Id.

The court of appeals first addressed the duty to disclose, and held that there was a fact question on that issue. The court held:

> RPP did not have full knowledge of all information about the retention bonus agreements until after this lawsuit was filed. Considering the evidence in the light most favorable to RPP, whatever information RPP knew was learned only after the conduct by Tate and Cuffia had occurred and before the retention bonus agreements had been finalized… even assuming that RPP had some knowledge of the retention bonus agreements before it signed the asset purchase agreement, such knowledge does not bar a claim for breach of fiduciary duty. An after-the-fact disclosure of the facts that form the basis of a breach-of-fiduciary duty claim does not restore the parties to a position as if there had been no breach.

Id. The court also held that the defendants' conduct also violated other fiduciary duties, other than a duty to disclose, and that the defendants did not move for summary judgment on those other breach claims.

Potentially, an officer or director may owe fiduciary duties to the corporation's creditors. For example, in *Tow v. Wellington Yu*, a bankruptcy trustee sued a corporation's shareholder and officer for breaching fiduciary duties by entering into a settlement agreement that required the sale of real estate where the defendant would take a percentage of the proceeds. No. H-14-3103, 2017 U.S. Dist. LEXIS 21987 (S.D. Tex. January 30, 2017). The defendant filed a motion for summary judgment, and the trial court denied that motion regarding the breach of fiduciary duty claim.

The court first cited to the opinion in *Weaver v. Kellogg*, 216 B.R. 563, 583 (S.D. Tex. 1997). In *Weaver*, the court held that under Texas law "corporate insiders . . . may have a fiduciary duty to the corporation's creditors even when the corporation [is] not insolvent." *Id*. The "corporate insiders" in Weaver were two sole shareholders and directors of the corporation. *Id*. at 581-84. The *Weaver* court held that the "Plaintiff may therefore prevail on his breach of corporate duty claims if he shows, for each allegedly wrongful transaction, that [the corporation] was, at the time, in the 'vicinity of insolvency'; that the transaction led to [the corporation's] insolvency; or that the transaction was a fraudulent conveyance." Id. at 584. The Weaver court found that it could not decide, at the summary judgment stage, the issue of whether the defendants had breached their fiduciary duties because the above listed fact issues had not been resolved.

In *Tow*, the defendant contended that he did not breach his fiduciary duty to the company and its creditors because the settlement agreement was in their best interests. The trustee argued that the defendant breached his fiduciary duty by negotiating the settlement agreement to give himself a portion of the proceeds from the sale of the property, rather than the company. The court noted that there was no dispute that defendant owed a fiduciary duty to the company as he was the sole shareholder of a company that was having major financial issues and was in the "vicinity of insolvency" at the time the settlement agreement was executed, which was a few months before the company filed for bankruptcy. The court concluded:

> Looking to Weaver, it is beyond debate that Defendant, as the sole shareholder and officer of PGI also owed a fiduciary duty to PGI's creditors. Defendant gave up PGI's interest in the Note and Deed of Trust, and he negotiated a settlement agreement where he kept a portion of the sale proceeds for himself, a non-party to the underlying transaction. Therefore, Defendant has failed to show that he did not breach his fiduciary duty to PGI as a matter of law. The court finds that a genuine issue of material fact exists whether Defendant breached his fiduciary duties to PGI, precluding summary judgment on Plaintiff's claim.

Id.

2. <u>Business Judgment Rule</u>

The business judgment rule may protect corporate officers and directors owing fiduciary duties to a corporation from liability for alleged breach of duties based on negligent, unwise, or imprudent acts if the acts were "within the exercise of their discretion and judgment in the development or prosecution of the enterprise in which their interests are involved." *Sneed v. Webre*, 465 S.W.3d 169, 178 (Tex. 2015). The rule does not protect a corporate officer or director from liability for dishonest, fraudulent, or self-dealing acts. *See Webre v. Sneed*, 358 S.W.3d 322, 336-37 (Tex. App.—Houston [1st Dist.] 2011) (business judgment rule does not apply in action for fraud or breach of fiduciary duty brought by shareholder against officer of closely-held corporation), *aff'd*, 465 S.W.3d 169; *see also Pace v. Jordan*, 999 S.W.2d 615, 624 (Tex. App.—Houston [1st Dist.] 1999, pet. denied) (business judgment rule does not apply if director/officer decision was "something beyond unsound business judgment"); *Lowry*, 537 S.W.3d at 615-16. Essentially, the business judgment rule operates as a requirement that a plaintiff plead more than "mere mismanagement," neglect, abuse of discretion, or unwise and inexpedient acts to state a cause of action. *See Sneed*, 465 S.W.3d at 186-87 (noting that "[i]t is insufficient for a shareholder plaintiff to allege a derivative right to relief against a corporation's officers or directors for breach of a duty based upon 'mere mismanagement or neglect . . . , or the abuse of discretion lodged in them in the conduct of the company's business,'" which allegations "may be disposed of on special exceptions or summary judgment") (quoting and citing Cates, 11 S.W. at 849)).

For example, in *Cardwell v. Gurley*, an appellate court affirmed a trial court's failure to apply business judgment rule to protect officers and directors from liability because plaintiff alleged, and evidence supported, defendants' breach of fiduciary duty by engaging in self-dealing and dishonest acts. No. 05-09-01068-CV, 2018 Tex. App. LEXIS 5460, 2018 WL 3454800, at *9 (Tex. App.—Dallas Jul. 18, 2018, pet. denied). *See also Ebert v. Dejoria (In re Latitude Sols., Inc.)*, No. 18-10382, 2019 U.S. App. LEXIS 13060 (5th Cir. April 30, 2019).

For example, in *In re Estate of Poe*, the son of a car dealership owner who was frozen out of control of the business by the dying father's decision to issue new stock sued his father's estate, trust, and officers of the business. No. 08-18-00015-CV, 2019 Tex. App. LEXIS 7842 (Tex. App.—El Paso August 28, 2019, pet. filed). The court of appeals held that the son had the burden to overcome the business judgment rule as a part of his breach of fiduciary duty claim. The court held that the son's claim that the directors breached their duty by delegating responsibilities to others failed:

> Bound up within the duty of care is the obligation to actually manage the affairs of the corporation. Yet we do not read into that duty the obligation to micromanage corporate affairs. Good corporate boards often rely on skilled employees to handle day-to-day operating decisions. Nothing suggests that Bock and Castro did not do that here. They continued the employment of two long-time managers at the Dodge and Chrysler dealerships, both of which Dick had originally hired. Sergent explained they did so to keep a continuity of experienced management who had relationships with the employees. They retained John Attel and initially placed him in charge of the parts and service departments of the dealerships. No witness criticized, or even specifically analyzed the profitability of those departments. Attel was later promoted to general manager, but with the approval of Chrysler. Finally, the board regularly met with management, and reviewed financials. We find no evidence of the breach of the duty of care in this record and the directed verdict was properly granted on that claim.

Id. The court found that the issue of whether the directors breached their duties by hiring a director to do legal work should have gone to the jury:

> Officers or directors self-deal when they make a personal profit from a transaction by dealing with the corporation. The burden of proof is on the interested officer or director to show that the action under consideration is fair to the corporation. As interested director transactions, each of the billings for professional services we note above might well be justified as fair to the corporation. The rates charged may have been appropriate for the service rendered. The burden of fairness, however, fell on the interested directors and not Richard. Just as Richard failed to explain the business decisions in sufficient detail for us to conclude there was some evidence of a violation of the business judgment rule, the record is similarly limited, or at least conflicting, on the fairness issue for these billings. We therefore remand the claims for disgorgement under the fiduciary duty of loyalty claim as to Bock and Sergent.

Id. The court then reviewed the conspiracy to breach fiduciary duty claims against the individual defendants, and held that those claims were properly dismissed because there was no evidence that they knew of an improper purpose in the transactions.

The business judgment rule should not apply to other types of fiduciary relationships. *See Ritchie v. Rupe*, 443 S.W.3d 856, n. 27 (Tex. 2014) ("This Court has never applied the business judgment rule to informal fiduciary duties before; no party argues that we should do so in this case; and because such duties arise separate and apart from business relationships, we see no reason to assume that the rule would apply.").

3. <u>Corporate Shareholders</u>

There are no formal fiduciary duties owed by a shareholder or between majority and minority shareholders in a closely-held corporation. *Ritchie v. Rupe*, 443 S.W.3d 856, n. 27 (Tex. 2014); *Willis v. Donnelly*, 199 S.W.3d 262, 276-77 (Tex. 2006); *Herring Bancorp, Inc. v. Mikkelsen*, 529 S.W.3d 216 (Tex. App.—Amarillo 2017, pet. denied); *Opperman v. Opperman*, No. 07-12-00033-CV, 2013 Tex. App. LEXIS 14867, at *10 (Tex. App.—Amarillo Dec. 9, 2014, no pet.); *Hoggett v. Brown*, 971 S.W.2d 472, 488 (Tex. App.—Houston [14th Dist.] 1997, no pet.) (no fiduciary duties between shareholders); *In re Fritz*, No. 15-347950BJH, 2017 Bankr. LEXIS 930 (N.D. Tex. Bankr. April 3, 2017) ("Under Texas law, however, 'a co-shareholder in a closely held corporation does not as a matter of law owe a fiduciary duty to his co-shareholder.'").

A fiduciary relationship between stockholders in corporation may, with sufficient evidence, be shown to exist in some instances where a confidential relationship between them is established. *Schoellkopf v. Pledger*, 739 S.W.2d 914, 920 (Tex. App.—Dallas 1987), *rev'd on other grounds*, 762 S.W.2d 145 (Tex. 1988). There must be some evidence on which the jury could rationally conclude that it was reasonable for one shareholder to expect the other to put the former's interests ahead of latter's own interests. *Van Bavel v. Oasis Design, Inc.*, No. 03-97-00434-CV,1998 Tex. App. LEXIS 5495, 1998 WL 546342, at *6 (Tex. App.—Austin Aug. 31, 1998, no pet.). Confidential relationships are discussed in more detail below.

Capacity is a very important issue to determine in order to judge the standard by which a party acts. If a party is acting solely in his or her capacity as a shareholder, he or she should not owe any fiduciary duties. For example, in *Liberty Bankers Life Ins. Co. v. Lenhard*, a company sued its former chief executive officer and shareholder for breaching fiduciary duties and fraudulent statements regarding an agreement to transfer his stock in the company. No. 3:16-CV-2417-N, 2019 U.S. Dist. LEXIS 19390 (N.D. Tex. February 6, 2019). The defendant filed a motion to dismiss the plaintiff's claims. Regarding the breach-of-fiduciary-duty claim, the court held that under Texas law, the plaintiff had to first show that the defendant owed a fiduciary duty. The court held that the plaintiff did not establish that the defendant owed a fiduciary duty because he was only acting in his capacity as shareholder in the transaction and not as an officer:

> Continental has not established a fiduciary duty existed at the time of sale. While it claims Lenhard owed a formal fiduciary duty because he was owner and CEO of Continental, he was not acting as CEO when he decided to sell the company. Rather, he was acting as a shareholder, and shareholders do not have the same special automatic fiduciary status corporate officers hold under Texas law. *In re Harwood*, 637 F.3d 615, 620 (5th Cir. 2011). In addition, there is no evidence that Continental relied on Lenhard for the sort of moral, financial, or personal support that is required to establish an informal fiduciary duty under Texas law. Assoc. *Indem. Corp. v. CAT Contracting, Inc.*, 964 S.W.2d 276, 288 (Tex. 1998). Indeed, this was purely an arms-length transaction between Lenhard and Liberty for Lenhard's shares in the company. That Continental representatives may have particularly trusted Lenhard's representations because of their previous relationship does not in itself mean he owed a fiduciary duty upon the sale. *See Meyer*, 167 S.W.3d. at 331. Accordingly, the Court dismisses Continental's breach of fiduciary duty claim.

Id. at 10-11. The court dismissed the breach-of-fiduciary-duty claim.

4. Employees and Employers

During their employment, employees owe fiduciary duties to their employer. *Samuel D. Orbison & Am. Piping Inspection v. Ma-Tex Rope Co.*, 553 S.W.3d 17 (Tex. App.—Texarkana 2018, pet. denied); *Cuidado Carsero Home Health v. Ayuda Home Heath Care Servs.*, 404 S.W.3d 737, 752 (Tex. App.—El Paso 2013, no pet.). An employee has a duty to act primarily for the benefit of the employer in matters connected with his agency. *Johnson v. Brewer & Pritchard, P.C.*, 73 S.W.3d 193, 200 (Tex. 2000). Among the agent's fiduciary duties to his principal are the duty not to compete with the principal on his own account in matters relating to the subject matter of the agency. *Id*. The employee has a duty to deal openly with the employer and to fully disclose to the employer information about matters affecting the company's business. *Bray v. Squires*, 702 S.W.2d 266, 270 (Tex. App.—Houston [1st Dist.] 1985, no writ). If an agent, while employed by his principal, uses his position to gain a business opportunity belonging to the employer, such conduct constitutes an actionable wrong. *Id*. The employee may not solicit the departure of other employees while still working for his employer. *Johnson*, 73 S.W.3d at 202; *Herider Farms-El Paso, Inc. v. Criswell*, 519 S.W.2d 473, 476 (Tex. Civ. App.—El Paso 1975, writ ref'd n.r.e.).

But an employer's right to demand and receive loyalty from an employee must be tempered by society's interest in encouraging competition. *See Johnson*, 73 S.W.3d at 201. Thus, in general, an at-will employee may plan to compete with his employer and take certain steps toward that goal without disclosing his plans to the employer, but he may not "appropriate his employer's trade secrets," "solicit his employer's customers while still working for his employer," "carry away certain information, such as lists of customers," or "act for his future interests at the expense of his employer by using the employer's funds or employees for personal gain or by a course of conduct designed to hurt the employer." *Id*. at 202.

In *Roberts v. Overby-Seawell Co.*, an employee sued his former employer for the failure to pay commissions. No. 3:15-CV-1217-L, 2018 U.S. Dist. LEXIS 47821 (N.D. Tex. March 23, 2018). The former employer filed a counterclaim for breach of fiduciary duty arising out of the employee's failure to disclose that he had an interest in other entities with whom the employer was entering into transactions. Both parties filed dispositive motions, and the court refused to dismiss the defendant's counterclaim. The employee argued that he did not owe a fiduciary duty and that the former employer had no evidence of damages arising from his alleged breach of fiduciary duties. The former employer argued that the employee owed a fiduciary duty and breached that duty by failing to disclose his ownership interest in other entities, and by focusing his time and effort on those entities to his own personal benefit instead of pursuing new business for the employer. The court stated:

> Texas recognizes that the agent-principal relationship gives rise to a fiduciary duty. An agent "has a duty to deal openly with the employer and to fully disclose to the employer information about matters affecting the company's business." Further, an agent who negotiates on behalf of his principal must disclose any adverse interest in the matter of the negotiation. An agent owes a "duty to deal fairly with the principal in all transactions between them." First, the court concludes that Roberts, acting as an agent who negotiated on behalf of OSC, owed Defendants a fiduciary duty that arose as a matter of law as part of the principal agent relationship. Second, contrary to Roberts's argument in his motion for summary judgment, Defendants do not need evidence of damages, as a benefit to the plaintiff suffices to prevail on a breach of fiduciary duty claim. Roberts's income tax returns are evidence of profits from these other businesses sufficient to raise a genuine dispute of material fact as to whether he benefited from the alleged breach. Having reviewed the summary judgment record, the court determines that the parties have provided conflicting evidence as to whether Roberts fully disclosed his ownership interest and active role in other entities to Defendants, including Equiguard Agency, Lendwell, and Tech2Roi. As this issue is at the heart of Defendants' breach of fiduciary duty counterclaim, the court will deny Roberts's motion for summary judgment on this counterclaim.

Id.

Employers do not owe fiduciary duties to their employees. *Pruitt v. United Chester Indus., Inc*., 2000 Tex. App. LEXIS 5767, 2000 WL 12100977, * 2 (Tex. App.—Dallas Aug. 28, 2000, pet. denied). For example, in *Espinosa v. Aaron's Rents, Inc.*, a former employee sued his former employer for defamation and other torts related to the defendant reporting 484 S.W.3d 533 (Tex. App.—Houston [1st Dist.] 2016, no pet.). One of the claims that the plaintiff asserted was that the defendant breached a fiduciary duty owed to the plaintiff, who used to be a manager for the defendant. The trial court granted the defendant a summary judgment on all of the plaintiff's claims. The court of appeals affirmed. Regarding the breach of fiduciary duty claim, the court held that the defendant did not owe the plaintiff a fiduciary duty as a matter of law. *Id*.; *City of Midland v. O'Bryant*, 18 S.W.3d 209, 216 (Tex. 2000) (holding that there is no duty of good faith and fair dealing in the employment context); *Beverick v. Koch Power, Inc*., 186 SW.3d 145,153 (Tex. App.—Houston [1st Dist.] 1997, pet. denied) ("Texas does not recognize a fiduciary duty or a duty of good faith and fair dealing owed by an employer to an employee.")); *Kardell v. Union Bankers Ins. Co.*, No. 05-01-00662-CV, 2002 Tex. App. LEXIS 5760, 2002 WL 1809867, at *7 (Tex. App.—Dallas Aug. 8, 2002, no pet.) (finding that a fiduciary duty did not exist between an employer and employee "based solely on the length of the employment relationship and the employee's subjective trust of the employer." (citing cases)); *Budri v. FirstFleet, Inc*., No. 3:19-CV-0409-N-BH, 2019 U.S. Dist. LEXIS 188251 (N.D. Tex. September 20, 2019) (supervisor did not owe fiduciary duty to employee).

5. <u>Agents</u>

An agency relationship can be formed by oral agreement between the parties or simply by the parties' conduct. *Community Health Systems Professional Services Corporation v. Hansen*, 525 S.W.3d 671 (Tex. 2017). An agency relationship creates a fiduciary relationship as a matter of law. *Crim Truck & Tractor Co. v. Navistar Intern. Transp. Corp.*, 823 S.W.2d 591, 52 A.L.R.5th 919 (Tex. 1992). Factors which must be taken into consideration when determining the scope of an agent's fiduciary duty include not only the nature and purpose of the relationship, but also agreements between the agent and principal. *National Plan Adm'rs, Inc. v. National Health Ins. Co.*, 235 S.W.3d 695 (Tex. 2007); *Man Industries (India), Ltd. v. Midcontinent Exp. Pipeline, LLC*, 407 S.W.3d 342 (Tex. App.—Houston [14th Dist.] 2013, no pet.). The agreement to act on behalf of the principal causes the agent to be a fiduciary, that is, a person having a duty, created by the agent's undertaking, to act primarily for the benefit of another in matters connected with such undertaking. *Stoneeagle Services, Inc. v. Davis*, 2013 WL 12143946 (N.D. Tex. 2013). The nature of the fiduciary duty owed by an agent is a high duty of good faith, fair dealing, honest performance, and strict accountability. *Salas v. Total Air Services, LLC*, 550 S.W.3d 683 (Tex. App.—El Paso 2018, no pet.); *Daniel v. Falcon Interest Realty Corp.*, 190 S.W.3d 177 (Tex. App.—Houston [1st Dist.] 2005, no pet.). Under Texas law, an agent has a general duty to disclose material facts to such individual's principal. *Patton v. Archer*, 590 F.2d 1319 (5th Cir. 1979). Specifically, an agent has the duty to impart to its principal every material fact relating to transactions within the scope of the agency on becoming aware of those facts during the course of the transaction. *Allison v. Harrison*, 137 Tex. 582, 156 S.W.2d 137 (Comm'n App. 1941). Under the principles that relate to fraud and deceit generally, an agent's conduct that constitutes a fraud on its principal renders the agent liable in damages to the principal. *Tyler Building & Loan Ass'n v. Baird & Scales*, 106 Tex. 554, 171 S.W. 1122 (1914).

A fiduciary may be held accountable for breaching its duty by acting negligently. *ERI Consulting Engineers, Inc. v. Swinnea*, 318 S.W.3d 867 (Tex. 2010). In determining an agent's liability for negligence, courts need not consider whether the agent acted in good faith; instead, courts are to inquire as to whether the agent complied with the legal standard of conduct required under the circumstances presented. *Highway Ins. Underwriters v. Lufkin-Beaumont Motor Coaches*, 215 S.W.2d 904 (Tex. Civ. App.—Beaumont 1948, writ refused n.r.e.).

B. Partners

Partners in a general partnership owe each other a fiduciary duty. *Bohatch v. Butler & Binion*, 977 S.W.2d 543, 545 (Tex. 1998) ("We have long recognized as a matter of common law that the relationship between partners is fiduciary in character, and imposes upon all the participants the obligation of loyalty to the joint concern and of the utmost good faith, fairness, and honesty in their dealings with each other with respect to matters pertaining to the enterprise."); *M.R. Champion v. Mizell*, 904 S.W.2d 617, 618 (Tex. 1995). The relationship between partners imposes upon all the participants the obligation of loyalty to the joint concern and of the utmost good faith, fairness, and honesty in their dealings with each other with respect to matters pertaining to the enterprise.

A managing partner owes the other partners one of the highest fiduciary duties recognized in law. *Huffington v. Upchurch*, 532 S.W.2d 576, 579 (Tex. 1976); *McBeth v. Carpenter*, 565 F.3d 171, 177 (5th Cir. 2009).

Similarly, a general partner in a limited partnership owes a fiduciary duty to the limited partners because of its control over the entity. *Crenshaw v. Swenson*, 611 S.W.2d 886, 890 (Tex. App.—Austin 1980, writ ref'd n.r.e.); *Johnson v. J. Hiram Moore, Ltd*., 763 S.W.2d 496, 499 (Tex. App.—Austin 1988, writ denied); *McBeth v Carpenter*, 565 F.3d 171, 177 (5th Cir. 2009); *see also In re Harwood*, 637 F.3d 615, 621 (5th Cir. 2011) ("under Texas law, 'the issue of control has always been the critical fact looked to by the courts' in determining whether to impose fiduciary responsibilities on individuals . . .").

C. Limited Partners

A limited partner owes a fiduciary duty to the partners and partnership if it actively engages in control over the operation of the business. *CBIF Ltd. P'ship v. TGI Friday's Inc.,* No. 05-15-00157-CV,2017 Tex. App. LEXIS 3605, 2017 WL 1455407, at *12 (Tex. App.—Dallas Apr. 21, 2017, pet. denied); *AMC Mortg. Strebel v. Wimberly*, 371 S.W.3d 267, 279 (Tex. App.—Houston [1st Dist.] 2012, pet. denied); *AON Props., Inc. v. Riveraine Corp.,* No. 14-96-00229-CV, 1999 Tex. App. LEXIS 199, 1999 WL 12739, at *23 (Tex. App.—Houston [14th Dist.] Jan. 14, 1999, no pet.) (not designated for publication).

However, some courts have held that limited partners that do not exercise control may not owe fiduciary duties as they are mere passive investors. *See, e.g., Strebel v. Wimberly,* 371 S.W.3d 267, 276 (Tex. App.—Houston [1st Dist.] 2012, pet. denied); *Crawford v. Ancira,* No. 04-96-00078-CV, 1997 Tex. App. LEXIS 2263, 1997 WL 214835, at *5 (Tex. App.—San Antonio, April 30, 1997, no writ) (not designated for publication). In *Crawford v. Ancira*, a limited partner plaintiff brought fraud claims against another limited partner in an attempt to avoid certain contractual obligations, claiming that limited partner had made misrepresentations to her that were contrary to the contractual terms. 1997 Tex. App. LEXIS 2263, 1997 WL 214835, at *4. Recognizing that the plaintiff's fraud claim was only viable if a fiduciary or confidential relationship existed between the parties, the San Antonio Court of Appeals rejected her claim. *Id*. The court reasoned that limited partners do not have the broad managerial powers enjoyed by general partners and, thus, "a person's mere status as a limited partner is insufficient to create fiduciary duties." 1997 Tex. App. LEXIS 2263, [WL] at *5.

Other courts hold that all limited partners owe fiduciary duties. *See McBeth v Carpenter,* 565 F.3d 171, 177 (5th Cir. 2009) ("With respect to fiduciary duties owed by . . . [defendant] limited partners to the Plaintiffs, Texas law recognizes such obligations between limited partners, applying the same partnership principles that govern the relationship between a general partner and limited partners."); *Zinda v. McCann St., Ltd*., 178 S.W.3d 883, 890-91 (Tex. App.—Texarkana 2005, pet. denied) (recognizing limited partners owe fiduciary duties to one another, including the duty to fully disclose all matters affecting the partnership and account for all profits and property, as well as a strict duty of good faith and candor).

A commentator and a court have reconciled these authorities into the following rule: that status as a passive investor does not give rise to fiduciary duties, but that a party's status as a limited partner does not insulate that party from the imposition of fiduciary duties that arise when a limited partner also takes on a nonpassive role by exercising control over the partnership in a way that justifies the recognition of such duties or by contract. *See* Colin P. Marks, *Limited Partnership Status and the Imposition of Fiduciary Duties in Texas*, 63 BAYLOR L. REV. 126, 128 (2010) ("[T]hough Texas jurisprudence has failed to articulate a clear rule, it is consistent with the cases decided thus far and the nature of a limited partnership to only create a fiduciary duty in certain equitable circumstances, such as when the limited partner is exercising control over the limited partnership or is also acting in the role of general partner."); *Strebel v. Wimberly*, 371 S.W.3d 267, 276 (Tex. App.—Houston [1st Dist.] 2012, pet. denied). The *Strebel* court held:

> When a person serves in a dual capacity as a limited partner and as a person controlling or managing the affairs of a limited partnership, it is not the party's status as a limited partner that gives rise to fiduciary duties; rather those duties exist by virtue of the additional relationship, such as agent or employee, in which capacity that person controls or manages the business of the partnership or by contract.

Strebel v. Wimberly, 371 S.W.3d at 276. It went on to state:

> We reconcile these cases by holding that status as a limited partner alone does not give rise to a fiduciary duty to other limited partners. That is not to say, however, that a party who is a limited partner does not owe fiduciary duties to other limited partners when that party, wearing a different hat, exerts operating control over the affairs of the limited partnership. For example, when a limited partner also serves as an officer of the limited partnership, as in McBeth, that partner may owe fiduciary duties based on his agency relationship to the partnership and the other limited partners, without regard for his limited partner role. The existence and scope of that duty will be defined not by the law governing limited partners, but rather by the relevant laws and contracts governing the role under which the party is exercising the authority.

Id.

Regarding the "control" that is necessary to create fiduciary duties, at least one court has referred to Texas Organizations Code Section 153.103 that provides as follows regarding what is *not* control:

For purposes of this section and Sections 153.102, 153.104, and 153.105, a limited partner does not participate in the control of the business because the limited partner has or has acted in one or more of the following capacities or possesses or exercises one or more of the following powers:

> (1) acting as: (A) a contractor for or an officer or other agent or employee of the limited partnership; (B) a contractor for or an agent or employee of a general partner; (C) an officer, director, or stockholder of a corporate general partner; (D) a partner of a partnership that is a general partner of the limited partnership; or (E) a member or manager of a limited liability company that is a general partner of the limited partnership;
>
> (2) acting in a capacity similar to that described in Subdivision (1) with any other person that is a general partner of the limited partnership;
>
> (3) consulting with or advising a general partner on any matter, including the business of the limited partnership;
>
> (4) acting as surety, guarantor, or endorser for the limited partnership, guaranteeing or assuming one or more specific obligations of the limited partnership, or providing collateral for borrowings of the limited partnership;
>
> (5) calling, requesting, attending, or participating in a meeting of the partners or the limited partners;
>
> (6) winding up the business of a limited partnership under Chapter 11 and Subchapter K of this chapter;
>
> (7) taking an action required or permitted by law to bring, pursue, settle, or otherwise terminate a derivative action in the right of the limited partnership;
>
> (8) serving on a committee of the limited partnership or the limited partners; or
>
> (9) proposing, approving, or disapproving, by vote or otherwise, one or more of the following matters: (A) the winding up or termination of the limited partnership; (B) an election to reconstitute the limited partnership or continue the business of the limited partnership; (C) the sale, exchange, lease, mortgage, assignment, pledge, or other transfer of, or granting of a security interest in, an asset of the limited partnership; (D) the incurring, renewal, refinancing, or payment or other discharge of indebtedness by the

> limited partnership; (E) a change in the nature of the business of the limited partnership; (F) the admission, removal, or retention of a general partner; (G) the admission, removal, or retention of a limited partner; (H) a transaction or other matter involving an actual or potential conflict of interest; (I) an amendment to the partnership agreement or certificate of formation; (J) if the limited partnership is qualified as an investment company under the federal Investment Company Act of 1940 (15 U.S.C. Section 80a-1 et seq.), as amended, any matter required by that Act or the rules and regulations of the Securities and Exchange Commission under that Act, to be approved by the holders of beneficial interests in an investment company, including: (i) electing directors or trustees of the investment company; (ii) approving or terminating an investment advisory or underwriting contract; (iii) approving an auditor; and (iv) acting on another matter that that Act requires to be approved by the holders of beneficial interests in the investment company; (K) indemnification of a general partner under Chapter 8 or otherwise; (L) any other matter stated in the partnership agreement; (M) the exercising of a right or power granted or permitted to limited partners under this code and not specifically enumerated in this section; or (N) the merger, conversion, or interest exchange with respect to a limited partnership.

Tex. Orgs. Code 153.103; *see also PNC Bank, N.A. v. 2013 Travis Oak Creek GP, LLC*, No. 1:17-CV-560-RP, 2017 U.S. Dist. LEXIS 222805, 2018 WL 6431005, at *11(W.D. Tex. Sept. 28, 2018).

D. Joint Venturers

A joint venture has four elements: (1) a community of interest in the venture, (2) an agreement to share profits, (3) an agreement to share losses, and (4) a mutual right of control or management of the enterprise. *Stutz Rd. Ltd. P'ship v. Weekley Homes, L.P.*, No. 05-12-01752-CV, 2015 Tex. App. LEXIS 11440 (Tex. App.—Dallas November 4, 2015, no pet.). Joint venturers are subject to the same rules that apply to partners. *Truly v. Austin*, 744 S.W.2d 934, 937 (Tex. 1988). Joint venturers owe one another a fiduciary duty with respect to dealings within the scope of the joint venture. *See Rankin v. Naftalis*, 557 S.W.2d 940, 944 (Tex. 1977); This fiduciary duty does not extend so far as to create duties in derogation of the express terms of the joint venture agreement. *See Deauville Corp. v. Federated Dept. Stores, Inc*., 756 F.2d 1183, 1194 (5th Cir. 1985) (holding that joint venturer did not breach a fiduciary duty by withdrawing from joint venture where joint venture agreement did not prohibit withdrawal). The fiduciary duty that partners owe one another does not encompass a duty to remain partners or else answer in tort damages. *See Bohatch v. Butler & Binion*, 977 S.W.2d 543, 546 (Tex. 1998).

For example, in *CBIF Ltd. P'ship v. TGI Friday's Inc.*, a joint venture partner sued the other partner for breaching fiduciary duties for unreasonably withholding consent regarding amending a lease and by acting out of its own self-interest in threatening the venture and its constituents with the total loss of the venture's business existence if it was not paid millions of dollars in order to buy out its interest in the venture. No. 05-15-00157-CV, 2017 Tex. App. LEXIS 3605, 2017 WL 1455407 (Tex. App.—Dallas Apr. 21, 2017, pet. denied). The defendant claimed that it could not be held liable for breach of fiduciary duty because it was merely exercising its contractual right to vote against proposed changes to the venture's governing documents and that its refusal to agree to the proposed modifications did not constitute a breach of fiduciary duty.

The court of appeals affirmed a finding that the defendant breached its fiduciary duty. The court held: "The relationship between partners is fiduciary in character, and imposes on all the participants the obligation of loyalty to the joint concern and of the utmost good faith, fairness, and honesty in their dealings with each other with respect to matters pertaining to the enterprise." *Id*. The court concluded that partners in a joint venture owed each other fiduciary duties. Regarding the defendant's argument that it did not breach any duty because it was just enforcing its contractual rights, the court stated that: "contracts do not exist in a vacuum. Rather, contractual rights, such as those claimed by CBIF, do not operate to the exclusion of fiduciary duties. Instead, where the two overlap, contractual rights must be exercised in a manner consistent with fiduciary duties." *Id*. The court reviewed the evidence and held:

> CBIF refused to amend the venture's governing documents to give the disadvantaged business entities the requisite level of control, placing TGIFJV in default of the lease's compliance requirement, which jeopardized the entire venture. The evidence also established that CBIF pursued its own self-interest at the expense of the joint venture by conditioning its waiver of its right of first refusal to purchase the 10% interest Friday's sold to Domain, to maintain a 35% DBE ownership interest in the joint venture, upon payment of $109,000. Considering and weighing all of the evidence in the record pertinent to the finding CBIF breached its fiduciary duty to Friday's, we conclude there is more than a scintilla of competent evidence to support the finding and the finding is not contrary to the overwhelming weight of all the evidence as to be clearly wrong and unjust..

Id.

E. Limited Liability Company Managers

While corporations and partnerships impose fiduciary obligations on corporate executives and partners, respectively, the Texas Business Organizations Code does not directly address the duties a manager or member owes to the LLC. *See* Tex. Bus. Orgs. Code Ann. §§ 101.001-101.622

Courts have held that where an LLC agreement does not eliminate fiduciary duties, that a manager of an LLC owes the same duties as a corporate officer or a partner. *See Straehla v. Al Global Servs., LLC*, No. 04-19-00812-CV, 2020 Tex. App. LEXIS 9889, 2020 WL 7364661 (Tex. App.—San Antonio Dec. 16, 2020, pet. filed) ("Although we do not have the Alpha Lobo LLC agreement in the record, we presume, based on the assumption inherent in section 101.401 of the Business Organizations Code that, Jorrie owed the same fiduciary duties that a corporate executive or partner would owe a corporation or partnership, unless the LLC agreement shows otherwise."); *Cardwell v. Gurley*, No. 05-09-01068-CV, 2018 Tex. App. LEXIS 5460, 2018 WL 3454800 (Tex. App.—Dallas July 18, 2018, pet. denied). As the *Gurley* court stated:

> Neither the Texas Limited Liability Company Act (TLLCA) nor the subsequently-enacted limited liability company provisions of the Texas Business Organizations Code (TBOC) directly address the duties owed by managers and/or members of limited liability companies. Both, however, presume the existence of fiduciary duties, providing that a limited liability company may "expand or restrict" any duties (including fiduciary duties) of a member, manager, officer, or other person. See Act of May 28, 1997, 75th Leg., R.S, ch. 375, S.B. 555, § 58, sec. 2.20(b), 1997 Gen. Laws 1516, 1565 (expired Jan. 1, 2010) (current version at Tex. Bus. Orgs. Code Ann § 101.401 (West 2012)).

2018 Tex. App. LEXIS 5460. The Business Organizations Code provides:

> The company agreement of a limited liability company may expand or restrict any duties, including fiduciary duties, and related liabilities that a member, manager, officer, or other person has to the company or to a member or manager of the company.

Tex. Bus. Orgs. Code Ann. § 101.401.

Further, where the LLC agreement provides for fiduciary duties to members, a manager owes direct duties to the members. In *Allen v. Devon Energy Holdings, L.L.C.*, a court interpreted a clause in a LLC agreement recognizing a manager's liability for breach of his "duty of loyalty to the company or its members" to include fiduciary obligations to both the company and its individual members. 367 S.W.3d 355 (Tex. App.—Houston [1st Dist.] March 9, 2012, pet. granted and remand by agr.). The *Allen* court stated:

> LLCs have a number of characteristics similar to partnerships, and courts in many jurisdictions have recognized a fiduciary duty between members of an LLC on that basis. An LLC may be run by its members collectively, like a general partnership, or it may be run by one or more manager-members, like a limited partnership. See Tex. Bus. Orgs. Code Ann. § 101.251. As the sole member-manager of Chief with a high degree of control, Rees-Jones's position with Chief is similar to that of a general partner in a limited partnership.
>
> …
>
> Thus, the relationship between Rees-Jones, as the majority owner and sole manager of Chief, and Allen, as a non-participating minority owner, is substantially similar to the relationship between the general partner and a limited partner in a limited partnership. The nature of this relationship supports recognizing a fiduciary duty between Rees-Jones and Allen with respect to Rees-Jones's operation and management of Chief.

Id.

In *In re Silver State Holdings*, in a bankruptcy proceeding a trustee of a limited liability company sued its former manager for breach of fiduciary duty and another entity for conspiracy to breach fiduciary duty arising out of a sale of property owned by the company. No. 19-41579-MXM 26 LLC, ADVERSARY NO. 19-4043-MXM 7901, 2020 Bankr. LEXIS 3531 (N.D. Tex. Bankr. December 17, 2020). The court first found that the manager owed fiduciary duties to the company:

> The Texas Business Organizations Code does not directly address the duties a manager or member owes to an LLC, but duty-of-loyalty concerns appear to underlie statutory provisions addressing transactions with governing persons and renunciation of business opportunities. Provisions of the Business Organizations Code permitting governing persons (including managers and managing members of an LLC) to rely on various types of information in discharging a duty implicitly recognize that such persons are charged with a duty of care in their decision making. Finally, the Business Organizations Code provides that, to the extent managers or members are subject to duties and liabilities, including fiduciary duties, the company agreement may expand or restrict the duties and liabilities. Based on these statutory provisions, Morash's status as an agent of 7901, and the particular facts of this case, the Court finds and concludes that he owed fiduciary duties to the company.

Id. The court then discussed what those fiduciary duties entailed:

> The duty of loyalty holds officers and directors to an "extreme measure of candor, unselfishness and good faith," particularly where there is an interested transaction. Interested transactions include those in which officers or directors derive personal profit as well as those which deprive the corporation of an opportunity to profit. A transaction between a fiduciary's company and another company in which the fiduciary has a significant financial interest is also an interested transaction. In such a situation, an officer or director must not allow his personal interests to prevail over the interests of the corporation. "A director who diverts profits from the corporation in violation of his fiduciary relationship is personally liable even though the profits are acquired by an agency controlled by the director." The burden is on the officer or director to establish the fairness of the transaction.

Id. The court held that the manager breached his fiduciary duties by allowing a foreclosure to occur and a sale to a third party because the company had equity in the property and the sale was not for a fair value. The court also held that the buyer was liable for conspiring with the manager and was jointly liable for the damages.

F. Limited Liability Company Members

As a business form, an LLC "afford[s] the corporation-like benefit of limited liability but with partnership tax treatment." *Shook v. Walden*, 368 S.W.3d 604, 613 n.10 (Tex. App.—Austin 2012, pet. denied). Therefore, the entity has characteristics like both a corporation and a partnership.

Some courts have held that non-managing LLC members generally do not owe each other any fiduciary duties. *Chahadeh v. Regions Bank*, No. 01-15-00656-CV, 2017 Tex. App. LEXIS 7203 (Tex. App.—Houston [1st Dist.] July 31, 2017, no pet.) ("No general duty exists between members of a limited liability corporation ("LLC"), but a manager of an LLC may owe a duty to the corporation and its members as defined in the agreement establishing the LLC.").

However, in *B Choice v. Epicentre Development Associates*, the federal district court affirmed a magistrate's recommendations concerning whether members of an LLC owe fiduciary duties to each other in Texas. No. H-14-2096, 2017 U.S. Dist. LEXIS 46284 (S. D. Tex. March 29, 2017). The court held that whether the members owed each other fiduciary duties was a fact question:

> With regard to the breach of fiduciary duty issue, the EpiCentre Defendants challenge the citation of *Allen v. Devon Energy Holdings, LLC*, 367 S.W.3d 355 (Tex. App-Houston [1st Dist] 2012, pet. granted, judgm't vacated, w.r.m.). However, the court finds that the part of the case that is cited was not overruled, is still good law, and supports the Magistrate Judge's decision that there is a genuine issue of material fact for the jury to decide whether some of the EpiCentre Defendants owed a fiduciary duty to plaintiff. To be clear, the court is aware that, in dicta, another court stated that as of April 2010, no Texas court had found that fiduciary duties existed between members of a limited liability company as a matter of law. *See Entertainment Merchandising Technology, LLC v. Houchin*, 720 F. Supp.2d 792, 797 (N.D. Tex. 2010). However, that court acknowledged in the next sentence that whether such fiduciary duty existed was typically a question of fact. Therefore, the court agrees with the Magistrate Judge that whether the EpiCentre Defendants owed a fiduciary duty to plaintiff is an issue of fact for the jury.

Id. The court then denied the defendant's motion for summary judgment on that ground.

In *Katz v. Intel Pharma, LLC*, a minority member of a limited liability company sued a former manager for breach of fiduciary duty in a derivative action. No. H-18-1347, 2020 U.S. Dist. LEXIS 120389 (S.D. Tex. July 9, 2020). The defendant filed a motion for summary judgment, alleging that he did not owe any fiduciary duties, and even if he did, the minority member could not raise them after the company was no longer in existence. The federal district court denied the motion.

The court stated: "A derivative action provides 'a procedural pathway for a minority shareholder to sue on behalf of the company for wrongs committed against the company.'" *Id*. (citing *In re Murrin Bros. 1885, Ltd*., No. 18-0737, 2019 Tex. LEXIS 1266, 2019 WL 6971663, at *4 (Tex. Dec. 20, 2019)). The court stated that it had not found a case expressly stating that under Texas law, an LLC's managing member owes the company fiduciary duties as a matter of law. "The Texas Business Organization Code is silent as to an LLC member's fiduciary duties, except to state that '[t]he company agreement of a limited liability company may expand or restrict any duties, including fiduciary duties, and related liabilities that a member, manager, officer, or other person has to the company or to a member or manager of the company.'" *Id*. (citing Tex. Bus. Orgs. Code Ann. § 101.401)). The court noted, however, that the cases support finding that "Suggs owed Intel Pharma fiduciary duties based on agency-law principles." *Id*. Further, the court noted:

> Intel Pharma's operating agreement also supports finding that Suggs, as its managing member, acted as the company's agent. The agreement provides that "[t]he Members, within the authority granted by the Act and the terms of this Agreement shall have the complete power and authority to manage and operate the Company and make all decisions affecting its business and [affairs]." The agreement does not "expand or restrict" fiduciary duties that Suggs owed to Intel Pharma.

Id. The court found, therefore, that the defendant did owe fiduciary duties as a manager to the company.

Regarding the defendant's argument that the plaintiff could not bring a derivative action where the company no longer existed, the court held:

> The record does not provide details of why Intel Pharma no longer exists. Katz's Second Amended Complaint alleges that in January 2017, the Texas Secretary of State revoked Intel Pharma's certificate of formation. Assuming that to be true, and that it caused a dissolution, Katz could still bring a derivative claim on the company's behalf. Under the Texas Business Organizations Code, a domestic business entity continues in existence for three years after termination or dissolution, for limited purposes. Tex. Bus. Orgs. Code Ann. § 11.356 (West 2006). One purpose is for "prosecuting or defending in the terminated filing entity's name an action or proceeding brought by or against the terminated entity." *Id*. § 11.356(a)(1). If the Texas Secretary of State revoked Intel Pharma's certificate and caused a dissolution, the company would continue to exist for three years for the purpose of having a derivative claim filed on its behalf. *See Gill v. Grewal*, No. 4:14-cv-2502, 2020 U.S. Dist. LEXIS 104461, 2020 WL 3171360, at *7 (S.D. Tex. June 15, 2020) (an LLC continued to exist for three years after dissolution for the purpose of a derivative suit). Katz sued in April 2018, less than three years from when the State allegedly revoked Intel Pharma's certificate of formation. (Docket Entry No. 1).

Id. Accordingly, the court denied the motion for summary judgment.

G. Married and Divorced Individuals

Business partners are often married. When they divorce (both in life and in business), they begin to look at each other's prior conduct and there may be breach of fiduciary duty claims. Spouses owe each other fiduciary duties. *See Ditta v. Conte*, 298 S.W.3d 187, 191 (Tex. 2009) ("[T]he marital relationship between spouses is a fiduciary relationship."). While spouses owe fiduciary duties to one another, ex-spouses generally do not. *See Solares v. Solares*, 232 S.W.3d 873, 881 (Tex. App.—Dallas 2007, no pet.) (holding that "in a contested divorce where each spouse is independently represented by counsel, the fiduciary relationship terminates"); *In re Marriage of Notash*, 118 S.W.3d 868, 872 (Tex. App.—Texarkana 2003, no pet.) (noting that any fiduciary duty between spouses terminates upon divorce); *Bass v. Bass*, 790 S.W.2d 113, 119 (Tex. App.—Fort Worth 1990, no writ) ("Although marriage may bring about a fiduciary relationship, such a relationship clearly does not continue when a husband and wife hire numerous independent professional counsel to represent them respectively in a contested divorce proceeding.").

H. Individuals Who Are Dating

However, a dating relationship (even a sexual relationship) before marriage does not generally rise to the level of a fiduciary relationship. *Markl v. Leake*, No. 05-17-00174-CV, 2018 Tex. App. LEXIS 3384 (Tex. App.—Dallas May 14, 2018, no pet.); *Markl v. Leake*, No. 05-15-00455-CV, 2015 Tex. App. LEXIS 11261 (Tex. App.—Dallas November 2, 2015, no pet.); *In re R.O*., No. 03-04-00506-CV, 2005 Tex. App. LEXIS 2990, 2005 WL 910231 (Tex.

App.—Austin Apr. 21, 2005, no pet.); *Smith v. Deneve*, 285 S.W.3d 904, 911 (Tex. App.—Dallas 2009, no pet.). In *Markl*, the court addressed whether a girlfriend owed an informal fiduciary duty to her boyfriend, who was someone else's husband. *Id*. The court held that while a marital relationship is a fiduciary one, that the relationship of girlfriend and boyfriend, without more, is generally not a fiduciary relationship. *Id*. The boyfriend argued that the following evidenced a fiduciary relationship between them: his longstanding romantic and sexual relationship with the girlfriend and the sums he expended on her behalf, coupled with her executing a will declaring him as the beneficiary and their mutual life insurance policies naming the other as a beneficiary. *Id*. The court held that the trial court had discretion to find that no fiduciary relationship existed via the girlfriend's testimony that they were simply girlfriend and boyfriend, a dating relationship substantively different from a marital union. *Id*.

I. Employees of Entities Who Are Partners Or Managers

Employees of an entity that is a general partner or manager of an LLC may not owe fiduciary duties in their individual capacities. *E-Learning LLC v. AT&T Corp.*, 517 S.W.3d 849 (Tex. App.—San Antonio 2017, no pet.). For example, in *Rainier Income Fund I v. Gans*, two limited partnerships sued an individual, who was the president of the general partner of the partnerships and co-owner of the only other limited partner, for breaching fiduciary duties allegedly owed to the limited partnerships. 501 S.W.3d 617 (Tex. App.—Dallas 2016, no pet.). The plaintiffs claimed that he breached fiduciary duties to them by not declaring the partnerships dissolved and liquidated. The trial court held that the defendant did not owe any fiduciary duties.

The court of appeals held that there are two types of fiduciary relationships—formal and informal. The court held that there was no evidence of a formal fiduciary relationship:

> Gans is not a partner in the partnership; he is an officer of the general partner. Although appellants cite several cases involving partners who owe duties, appellants do not cite any case for the proposition that an officer of the general partner of a partnership owes a fiduciary duty to the partnership. Instead, they argue Gans "cannot be distinguished from the entities he controls." Appellants did not, however, allege that the corporate identity of Star Creek, the general partner, should be disregarded. Appellants have not shown a formal fiduciary relationship.

Id. The court also held that the plaintiffs did not prove that the individual defendant had an informal fiduciary relationship because they did not direct the court to any evidence to show a prior relationship between the parties existed.

However, a federal district court held that employees of fiduciaries may have individual liability for their actions. *Medve v. JPMorgan Chase Bank, N.A.*, No. H-15-2277, 2016 U.S. Dist. LEXIS 11961 (S.D. Tex. February 2, 2016). That court noted that there are three separate legal bases under Texas law for imposing liability on an employee who carries out the fiduciary functions of an entity: "(1) first, the employee owes a fiduciary duty directly as a subagent carrying out the employer's fiduciary functions, (2) second, the employee is liable if he 'participates' in the employer's breach of fiduciary duty, which the employee necessarily does if he is the one carrying out the breaches, and (3) third, the employee is personally liable for any tort he commits in the course of his employment, and breach of fiduciary duty is of course a tort." *Id*. (citing *In re Merrill Lynch Trust Co. FSB*, 235 S.W.3d 185 (Tex. 2007); *Leyendecker & Assocs., Inc. v. Wechter*, 683 S.W.2d 369, 375 (Tex. 1984); *Searle-Taylor Mach. Co. v. Brown Oil Tools, Inc*., 512 S.W.2d 335, 338 (Tex. Civ. App.—Houston [1st Dist.] 1974, writ ref'd n.r.e.)). These issues were not raised in the *Gans* case, and the court in that case did not address these other potential arguments.

J. Confidential Relationships

Two types of relationships give rise to fiduciary duties: formal and informal. *Meyer v. Cathey*, 167 S.W.3d 327, 330-31 (Tex. 2005). An informal relationship also may give rise to a fiduciary duty when one person trusts and relies on another, whether the relationship is moral, social, domestic, or purely personal. *Crim Truck & Tractor Co. v. Navistar Int'l Transp. Corp*., 823 S.W.2d 591, 593-94 (Tex. 1992), superseded by statute on other grounds as noted in *Subaru of Am., Inc., v. David McDavid Nissan, Inc.*, 84 S.W.3d 212, 225-26 (Tex. 2002). "A person is justified in believing another to be his fiduciary 'only where he or she is accustomed to being guided by the judgment and advice of the other party, and there exists a long association in a business relationship, as well as a personal friendship.'" *McAfee, Inc*., 316 S.W.3d at 829 (quoting *Pabich v. Kellar*, 71 S.W.3d 500, 505 (Tex. App.—Fort Worth 2002, pet. denied)); *see also Willis v. Donnelly*, 199 S.W.3d 262, 277 (Tex. 2006) ("[T]o impose such a relationship in a business transaction, the relationship must exist prior to, and apart from, the agreement made the basis of the suit."). The existence of an informal fiduciary relationship is usually a question of fact. *Crim Truck & Tractor Co*., 823 S.W.2d at 594; *Siddiqui v. Fancy Bites, LLC*, 504 S.W.3d 349, 367 (Tex. App.—Houston [14th Dist.] 2016, pet. denied).

The existence of an informal relationship is "determined from the actualities of the relationship of the persons involved." *Thigpen v. Locke*, 363 S.W.2d 247, 253 (Tex. 1962). If a business transaction is involved, "the special relationship of trust and confidence must exist prior to, and apart from, the agreement made the basis of the suit." *Associated Indem. Corp. v. CAT Contracting, Inc*., 964 S.W.2d 276, 288 (Tex. 1998).

For example, in *Shearer v. Shearer*, the court of appeals affirmed a finding of a confidential relationship. No. 12-14-00302-CV, 2016 Tex. App. LEXIS 5685 (Tex. App.—Tyler May 27, 2016, no pet.). An ex-wife made several decisions for treatment for her ex-husband. Without consulting the man's son, she executed the DNR the following morning, and the hospital withdrew all life-sustaining care. The man died two days later. The son sued her for breach of fiduciary duty and intentional infliction of emotional distress concerning the woman's nondisclosure of her decisions that deprived the son of the chance to see his father prior to his death. The jury awarded the son damages and the woman appealed.

The court of appeals first reviewed the law regarding informal fiduciary relationships. The court held that they are not created lightly, and that fiduciary relationships juxtapose trust and dependence on one side with dominance and influence on the other. The problem is one of equity, and the circumstances giving rise to the confidential relationship are not subject to hard and fast lines. A confidential relationship exists where a special confidence is reposed in another who in equity and good conscience is bound to act in good faith and with due regard to the interest of the one reposing confidence. Factors to consider include whether the plaintiff justifiably relied on the defendant for support, the plaintiff's physical and mental condition, and evidence of the plaintiff's trust. Subjective trust, alone, is not sufficient, and the trust must be justifiable. There must be additional circumstances, or a relationship that induces the trusting party to relax the care and vigilance that he would ordinarily exercise for his own protection. A court should examine whether, because of a close or special relationship, the plaintiff is in fact accustomed to being guided by the judgment or advice of the other. Another factor is the length and depth of the parties' relationship, although a long personal relationship alone is insufficient to create a fiduciary relationship. For example, a familial relationship, while considered a factor, does not by itself establish a fiduciary relationship.

The court of appeals looked at the facts and held that "there were peculiar circumstances inducing David to relax the care and vigilance that he would ordinarily exercise for his own protection. Thus, the jury could rationally have concluded that Corrine acquired influence over David and abused it, and that David's confidence had been reposed and betrayed… Because the issue is one of equity, under these unique facts, a reasonable jury could have concluded that the relationship developed sufficiently during the relevant time period to justify David's reliance on Corrine." *Id*. The court of appeals affirmed the jury's finding of a breach of fiduciary duty.

In *Gill v. Grewal*, the suit arose out of a failed business venture between old college friends. No. 4:14-CV-2502, 2020 U.S. Dist. LEXIS 104461 (S. D. Tex. June 15, 2020). Gill and Grewal attended college together in the late 1960s. After falling out of touch with each other for over thirty years, the two reconnected at a wedding. The day after the wedding, Grewal pitched Gill an entrepreneurial venture related to the healthcare industry. The parties then formed Healthema. After a dispute arose, Grewal sued his former friend for breaching fiduciary duties arising from the formation and operation of the business. Gill filed a motion for summary judgment, alleging that he did not owe any fiduciary duties to Grewal. The district court granted the summary judgment motion on this issue. The court stated:

> Apart from formal fiduciary relationships, Texas courts "also recognize an informal fiduciary duty that arises from 'a moral, social, domestic or purely personal relationship of trust and confidence.'" That being said, "[i]n order to give full force to contracts, [Texas courts] do not create such a relationship lightly." "It has long been recognized that not every relationship involving a high degree of trust and confidence rises to the stature of a fiduciary relationship." "[I]n the context of a business transaction, to impose an informal fiduciary duty, the special relationship of trust and confidence must exist prior to, and apart from, any agreement made the basis of the suit." "Where the underlying facts are undisputed, determination of the existence, and breach, of fiduciary duties are questions of law, exclusively within the province of the court."
>
> Here, Grewal contends that he placed "'complete' trust in J. Gill based on their history of close friendship, and this high degree of personal trust was the reason he allowed J. Gill and S. Gill to maintain exclusive control over Healthema's bank account while he was in India." The extent of the personal relationship between J. Gill and Grewal is summed up in the affidavit by Grewal that accompanied his motion for summary judgment… Summarized, Grewal and J. Gill were college friends who kept in touch for a few years, then fell out of contact for thirty-five years. They reconnected at a wedding, and based upon a number of written contracts, Healthema was launched within two months of the duo reconnecting. J. Gill

> argues that these facts fall well short of creating a fiduciary duty, especially in light of the Supreme Court of Texas's statement that it "do[es] not create such a relationship lightly."
>
> The Court agrees. While we all hope that our old college friends hold us in high regard, few would expect these long-lost friends to make their interests subservient to our own, much less following a thirty-five-year break in communication. Yet "[t]he effect of imposing a fiduciary duty is to require the fiduciary party to place someone else's interests above its own." For that reason, the Supreme Court of Texas has declined to "impos[e] a fiduciary duty based on the fact that, for four years, [the parties] were friends and frequent dining partners." Moreover, "mere subjective trust does not . . . transform arm's length dealing into a fiduciary relationship." Therefore, "the fact that [Grewal] [completely] trusted [S. Gill] does not transform their business arrangement into a fiduciary relationship." For those reasons, the Court also grants J. Gill's motion for summary judgment on Grewal's breach of fiduciary duty claims.

Id.

K. Impact Of Pre-Existing Fiduciary Duties

There are risks involved with fiduciaries entering into business deals with their principals. Examples of fiduciaries who may enter into transactions with principals are attorney/client, trustee/beneficiary, power of attorney agent/principal, and executor/beneficiary. Additionally, certain confidential relationships can lead to fiduciary duties. A fiduciary owes a principal a duty of loyalty and should look out for the principal's interests above the fiduciary's interests. Due to this, transactions between a fiduciary and principal are closely monitored by the courts, and there is a presumption that they are invalid. The fiduciary has the burden to prove that the transaction is fair. *Fitz-Gerald v. Hull*, 150 Tex. 39, 49, 237 S.W.2d 256, 261 (1951). *See also Keck, Mahin & Cate v. Nat'l Union Fire Ins. Co.*, 20 S.W.3d 692, 699 (Tex. 2000) (considering whether a release agreement could bar claims arising from a fiduciary relationship and holding that the presumption of unfairness or invalidity applied). To establish the fairness of a transaction between a fiduciary and his principal, relevant factors include: (1) there was full disclosure regarding the transaction, (2) the consideration (if any) was adequate, (3) the beneficiary had the benefit of independent advice, (4) the party owing the fiduciary duty benefited at the expense of the beneficiary, and (5) the fiduciary significantly benefited from the transaction as viewed in light of the circumstances in existence at the time of the transaction. *Jordan v. Lyles*, 455 S.W.3d 785, 792 (Tex. App.—Tyler 2015, no pet.); *Lee v. Hasson*, 286 S.W.3d 1, 21 (Tex. App.—Houston [14th Dist.] 2007, pet. denied). For example, in *In re Estate of Miller*, the court held that the fiduciary failed to prove the fairness of a loan transaction between the principal and agent and that transaction was, therefore, a breach of fiduciary duty. 446 S.W.3d 445, 450 (Tex. App.—Tyler 2014, no pet.). So, before a fiduciary enters into a transaction with the principal, it should be very careful to: disclose all known facts about the transaction and the risks involved with same and the benefits that the fiduciary may gain from the transactions, ensure that the fiduciary pays fair consideration for the interest that it is obtaining, and make sure that the principal has independent counsel and advice. It is a good idea to enter into a written agreement between the fiduciary and principal that, in addition to other provisions, makes the required disclosures, provides that the consideration by the fiduciary is adequate and that the benefits are fair, provides that the principal has obtained independent counsel, and provides that the principal is not relying on the fiduciary's duties to him or her regarding the transaction.

For example, in *Adam v. Marcos*, an attorney and his client agreed to a joint venture/partnership. 620 S.W.3d 488 (Tex. App.—Houston 2021, pet. filed). The attorney sued the client for breaching the agreement. The trial court ruled for the client on the attorney's breach of the partnership agreement claim and a breach of fiduciary duty claim. The court of appeals affirmed. The court of appeals first held that the partnership agreement was presumptively invalid because the attorney owed fiduciary duties to the client when it was entered into:

> Contracts between attorneys and their clients negotiated during the existence of the attorney-client relationship are closely scrutinized. Because the relationship is fiduciary in nature, there is a presumption of unfairness or invalidity attaching to such contracts. The burden is on the attorney to prove the fairness and reasonableness of the agreement. Moreover, as a fiduciary, Marcos had the burden to establish that Adam was informed of all material facts relating to the agreement. Additional important factors in determining the fairness of a transaction involving a fiduciary include whether the consideration was adequate and whether the beneficiary obtained independent advice.

Id. The court of appeals held that the jury's finding of breach of duty by the attorney supported invalidating the partnership agreement: "Because the jury found that Marcos failed to fulfill his fiduciary duties to Adam in regard to the alleged partnership agreement, and the evidence supports that finding, the presumption that the contract was invalid applies. Thus, the trial court did not err in holding the agreement was invalid and unenforceable." *Id.*

The court of appeals then held that the client did not owe any fiduciary duties to the attorney and affirmed the trial court's judgment for the client on that claim:

> To recover on a breach of fiduciary duty claim, a plaintiff must prove that (1) a fiduciary relationship existed between the plaintiff and the defendant, (2) the defendant breached his or her fiduciary duty to the plaintiff, and (3) the defendant's breach resulted in an injury to the plaintiff or a benefit to the defendant. The only basis Marcos alleges for a fiduciary relationship in which Adam owes fiduciary duties to him is the partnership agreement. As discussed in the previous section, the alleged partnership agreement between Marcos and Adam was invalid and unenforceable. Fiduciary relationships do not arise from unenforceable contracts. Without a fiduciary relationship between Marcos and Adam, Adam could not be liable for breaching any fiduciary duties to Marcos; thus, the trial court did not err in granting a directed verdict on Marcos's breach of fiduciary duty claim.

Id. The court of appeals affirmed the judgment for the client.

L. Net-Widening Theories

Even where a party may not owe a direct fiduciary duty to an entity or to an owner, it can still be liable for breaches of fiduciary duty under certain net-widening theories.

1. <u>Aiding-and-Abetting Claims Generally</u>

There are three general types of aiding and abetting liability under the current Restatement of Torts, but this section of the Restatement has not been expressly adopted in Texas and "whether such a theory of liability is recognized in Texas is an open question." *First United Pentecostal Church of Beaumont v. Parker*, 514 S.W.3d 214 (Tex. 2017); *Juhl v. Airington*, 936 S.W.2d 640, 643 (Tex. 1996); In re Dole, 256 S.W.3d 851, 856 (Tex. App.—Beaumont 2008, orig. proceeding). Even if the theory is adopted, it would require a jury question or instruction on responsibility pursuant to the actor's concert of action with the actual wrongdoer. *Edmunds v. Sanders,* 2 S.W.3d 697, n.2 (Tex. App.—El Paso 1999, pet. denied) (refusing theory as it had not been adopted).

The first type of liability is generally called "concert of action," and its elements are: (1) the defendant and another committed an intentional tort or were grossly negligent, (2) the tort was highly dangerous, deviant, or antisocial group activity likely to cause serious injury or death to a person or certain harm to a large number of people, (3) the defendant agreed (explicitly or tacitly) to cooperate in a particular plan or to accomplish a particular result, (4) the defendant's own conduct was tortious, and (5) the tortious conduct of the defendant and the other actor caused the plaintiff's injury. *Juhl v. Airington*, 936 S.W.2d 640, 643-44 (Tex. 1996); *Crisp v. Southwest Bancshares Leasing Co.*, 586 S.W.2d 610, 613 (Tex. App.—Amarillo 1979, writ ref'd n.r.e.); Restatement (Second) of Torts, § 876(a) (1979). The *Juhl* court stated, "if we were to adopt § 876(a) we would require allegations of specific intent, or perhaps at least gross negligence, to state a cause of action." *Juhl,* 936 S.W.2d at 644. Specific intent requires an agreement to accomplish an unlawful purpose or to accomplish a lawful purpose by unlawful means; neither proof of negligence nor proof of intent to engage in the conduct that resulted in the injury is enough. *See id.* The concert-of-action theory is designed "to deter antisocial or dangerous behavior," such as drag racing, group assault, reckless driving, and assisting a driver in becoming intoxicated. See id.; see also Martinez v. Ford Motor Credit Co., No. 04-11-00306-CV, 2012 Tex. App. LEXIS 7230, at *14 (Tex. App.—San Antonio Aug. 29, 2012, pet. denied); III Forks Real Estate, L.P. v. Cohen, 228 S.W.3d 810, 815-16 (Tex. App.—Dallas 2007, no pet).

The second type of liability is generally called "assisting or encouraging," and the elements are: (1) the primary actor committed a tort; (2) the defendant had knowledge that the primary actor's conduct constituted a tort; (3) the defendant had the intent to assist the primary actor in committing the tort; (4) the defendant gave the primary actor assistance or encouragement, and (5) the defendant's assistance or encouragement was a substantial factor is causing the tort. *Juhl v. Airington*, 936 S.W.2d at 643-44; *Crisp v. S.W. Bancshares Leasing Co.*, 586 S.W.2d 610, 613 (Tex. App.—Amarillo 1979, writ ref'd n.r.e.); Restatement (Second) of Torts, § 876(b) (1979). In *Juhl*, the court noted subsection (b) of section 876 requires "substantial assistance" and knowledge that the tortfeasor's conduct constitutes a breach of duty. *Juhl,* 936 S.W.2d at 644. Therefore, under subsection (b), unlawful intent is required—i.e., "knowledge that the other party is breaching a duty and the intent to assist that party's actions." *Id*.

The third type of liability is generally called "assisting and participating," and its elements are: (1) the primary actor's activity accomplished a tortious result, (2) the defendant proved substantial assistance to the primary actor in accomplishing the tortious result, (3) the defendant's own conduct, separate from the primary actor's, was a breach of duty to the plaintiff, and (4) the defendant's participation was a substantial factor in causing the tort. See Restatement (Second) of Torts, § 876(c) (1979). The *Juhl* court also noted that the comments to the Restatement listed five factors to consider in determining whether "substantial assistance" had been provided: (1) the nature of the wrongful act; (2)

the kind and amount of the assistance; (3) the relation of the defendant and the actor; (4) the presence or absence of the defendant at the occurrence of the wrongful act; and (5) the defendants state of mind. *Juhl*, 936 S.W.2d at 644. If a plaintiff prevails, it can recover whatever damages are available for the underlying tort. *Cf. Tilton v. Marshall*, 925 S.W.2d 672, 681 (Tex. 1996). Liability for assisting or encouraging is joint and several.

2. Aiding-and-Abetting or Knowing Participation Claims for Breach of Fiduciary Duty

The Texas Supreme Court has not expressly adopted an aiding-and-abetting-breach-of-fiduciary-duty claim. *See First United Pentecostal Church of Beaumont v. Parker*, 514 S.W.3d 214, 220 (Tex. 2017). Typically, only the Texas Supreme Court or the Texas Legislature can create new common law claims. *Jackson Walker, LLPO v. Kinsel*, 518 S.W.3d 1 (Tex. App.—Amarillo 2015), *aff'd* 526 S.W.3d 411 (Tex. 2017) (dismissing tortious interference with inheritance claim as it had not been recognized by the Texas Legislature or the Texas Supreme Court). In *First United Pentecostal Church*, the Court recognized that it had previously expressly stated that Texas had not adopted an aiding and abetting claim. 514 S.W.3d 214, 220 (Tex. 2017). In *Juhl*, the Court held that there was a question as to whether there is a concert-of-action theory in Texas in a case that concerned whether a group of parties were responsible for a negligence claim; thus, the Court in *Juhl* did not specifically address a breach of fiduciary duty claim. *Juhl*, 936 S.W.2d at 643. Therefore, there is a very good argument that, because the Texas Supreme Court and the Texas Legislature have not recognized an aiding and abetting breach of fiduciary duty claim, that no such claim exists.

Interestingly, however, the Court has previously held that there is a claim for "knowing participation" in a breach of fiduciary duty in Texas. *Kinzbach Tool Co. v. Corbett-Wallace Corp*., 138 Tex. 565, 160 S.W.2d 509, 513-14 (Tex. 1942). When a third party knowingly participates in the breach of a fiduciary duty, the third party becomes a joint tortfeaser and is liable as such. *Kinzbach Tool Co. v. Corbett-Wallace Corp.*, 138 Tex. 565, 160 S.W.2d 509, 513-14 (Tex. 1942); *Kaster v. Jenkins & Gilchrist, P.C.*, 231 S.W.3d 571, 580 (Tex. App.—Dallas 2007, no pet.); *Brewer & Pritchard, P.C. v. Johnson*, 7 S.W.3d 862, 867 (Tex. App.—Houston [1st Dist.] 1999), *aff'd on other grounds*, 73 S.W.3d 193 (2002). A cause of action premised on a contribution to a breach of fiduciary duty must involve the knowing participation in such a breach. *Cox Tex. Newspapers, L.P. v. Wooten*, 59 S.W.3d 717, 722 (Tex. App.—Austin 2001, pet. denied). The general elements for a knowing-participation claim are: (1) the existence of a fiduciary relationship; (2) the breach of a fiduciary duty; (3) the third party knew of the fiduciary relationship; and (4) the third party was aware it was participating in the breach of that fiduciary relationship. *Darocy v. Abildtrup*, 345 S.W.3d 129, 137-38 (Tex. App.—Dallas 2011, no pet); *see also Meadows v. Harford Life Ins. Co.*, 492 F.3d 634, 639 (5th Cir. 2007).

One older court has stated that it is not settled whether "knowing participation/aiding and abetting" is a viable cause of action in Texas. *Shinn v. Allen*, 984 S.W.2d 308, 310 (Tex. App.—Houston [1st Dist.] 1998, no pet.) (citing *Juhl v. Airington*, 936 S.W.2d 640, 643 (Tex. 1996)). However, more recently, a federal district court determined that it is "well settled" that where a third party knowingly participates in the breach of duty of a fiduciary, Texas law such third party becomes a joint tortfeasor with the fiduciary and is liable as such." *Samsung Elec. Am. v. Chung*, No. 3:15-CV-4108-D, 2017 U.S. Dist. LEXIS 21700 (N.D. Tex. Feb. 16, 2017) (citing *Kinzbach Tool*, 160 S.W.2d at 514). In that case, the court held that in order to state a claim for aiding and abetting breach of fiduciary duties, the plaintiff must show: (1) the existence of a fiduciary relationship; (2) that the third party knew of the fiduciary relationship; and (3) that the third party was aware that it was participating in the breach of that fiduciary relationship. 2017 U.S. Dist. LEXIS 21700 (citing *Meadows v. Hartford Life Ins. Co*., 492 F.3d 634, 639 (5th Cir. 2007)). Another case held that there was no aiding and abetting claim but that there was a knowing participation claim. *Taylor v. Rothstein Kass & Co., PLLC*, No. 3:19-CV-1594-D, 2020 U.S. Dist. LEXIS 17435 (N.D. Tex. February 4, 2020).

Whether framed as a "knowing participation" or as "aiding and abetting" a breach of fiduciary duty, the elements would require an inquiry into the party's knowledge. For example, in *Milligan v. Salamone*, the Greenberg Taurig law firm represented the bankrupt company when it sued a president and board member. No. 1:18-CV-327-RP, 2019 U.S. Dist. LEXIS 41009 (W.D. Tex. March 14, 2019). Greenberg drafted an agreement that would cancel the president's employment contract, release him from his non-competition and non-solicitation obligations, and promise to pay him any accrued obligations (the "Cancellation Agreement"). A bankruptcy trustee later asserted claims against Greenberg for (1) breach of fiduciary duty, (2) aiding and abetting breaches of fiduciary duty, and (3) malpractice and negligence arising from its preparation of the Cancellation Agreement. Greenberg filed a motion to dismiss, which the bankruptcy court granted, and the trustee appealed to the district court.

The district court affirmed the dismissal of the direct breach of fiduciary duty claims because, although the trustee alleged a conflict of interest, there were no allegations that Greenberg represented the company and the president in his individual capacity at the same time. The court affirmed the dismissal of the professional negligence claim because the trustee did not allege sufficient allegations of proximate cause.

The court then turned to the aiding and abetting breach of fiduciary duty allegations. The district court reversed the bankruptcy court's dismissal of that claim. Regarding the legal basis for an aiding and abetting claim, the court stated:

> The Texas Supreme Court "has not expressly decided whether Texas recognizes a cause of action for aiding and abetting." However, Texas appellate courts have repeatedly held that "a party who knowingly participates in another's breach of fiduciary duty may be liable for the breach as a joint tortfeasor." "To establish a claim for knowing participation in a breach of fiduciary duty, a plaintiff must assert: (1) the existence of a fiduciary relationship; (2) that the third party knew of the fiduciary relationship; and (3) that the third party was aware that it was participating in the breach of that fiduciary relationship." It is the final requirement—Greenberg's knowledge that it was participating in a breach of fiduciary duty—that is before the Court now.

Id.

The trustee alleged that the president and the other board member created the Cancellation Agreement to allow them to compete with, and thereby destroy, the company. The court held that: "To have known that it was participating in Halder and Salamone's breach of fiduciary duty, Greenberg would have to have known that their actions were fraudulent, taken in bad faith, or constituted self-dealing." Id. The trustee alleged that Greenberg aligned with the president and board member during the board-control fight and drafted the agreement on its own initiative when it became clear that the company would not renew the president's contract. The bankruptcy court determined from these allegations that Greenberg did not plausibly know enough to participate in the directors' breaches of duty. The district court disagreed:

> Milligan has still plausibly alleged Greenberg's knowledge that the agreement was a violation of Salamone and Halder's fiduciary duties. Taking Milligan's other allegations as true, a factfinder could infer that Greenberg knew the Cancellation Agreement was not in Westech's interest, and therefore that in drafting the agreement, Greenberg was helping Halder self-deal on his way out of the company. As the Bankruptcy Court found, Greenberg could plausibly have known that Westech was not in breach of its obligations to Halder under Halder's employment contract, and that therefore the company would have owed Halder substantially less money if it had simply not renewed his contract. Greenberg would then have known that Westech was receiving nothing in exchange for releasing Halder from his restrictive covenants. Considered in context—the control battle, Salamone and Halder's alignment on the board, Halder's imminent contract expiration—a factfinder could infer that Greenberg knew that the Cancellation Agreement was a sweetheart deal for Halder. That Greenberg allegedly drafted the agreement on its own accord suggests that it was conscious of the reasons behind the agreement's structure. Greenberg's motion to dismiss Milligan's aiding-and-abetting claim—perhaps better characterized as a knowing-participation claim under Texas law—is therefore denied. The Bankruptcy Court's order is vacated as it pertains to that claim.

Id.

3. <u>Conspiracy</u>

A civil conspiracy involves a combination of two or more persons to accomplish an unlawful purpose, or to accomplish a lawful purpose by unlawful means. *Tilton v. Marshall*, 925 S.W.2d 672, 681 (Tex. 1996). Conspiracy is a derivative tort because "a defendant's liability for conspiracy depends on participation in some underlying tort for which the plaintiff seeks to hold at least one of the named defendants liable." *Id.; see also Hagerman v. Wells Fargo*, No. 03-03-00769-CV, 2006 Tex. App. LEXIS 7559 (Tex. App.—Austin no pet.). The parties "must be aware of the harm or wrongful conduct at the inception of the combination or agreement." *Triplex Comm'ns v. Riley*, 900 S.W.2d 716, 719 (Tex. 1995); *see also Greenlee Enters. v. Compass Bank, N.A.*, No. 05-10-00490-CV, 2011 Tex. App. LEXIS 9519 (Tex. App.—Dallas December 5, 2011, no pet.); *Crescendo Invs., Inc. v. Brice*, 61 S.W.3d 465, 473 (Tex. App.—San Antonio 2001, pet. denied) ("The meeting of the minds requirement requires knowledge of the course of action and specific intent."); *First Interstate Bank of Texas, N.A. v. S.B.F.I., Inc.*, 830 S.W.2d 239, 249 (Tex. App.—Dallas 1992, no writ).

The Texas Supreme Court held that an action for civil conspiracy has five elements: (1) a combination of two or more persons; (2) the persons seek to accomplish an object or course of action; (3) the persons reach a meeting of the minds on the object or course of action; (4) one or more unlawful, overt acts are taken in pursuance of the object or course of action; and (5) damages occur as a proximate result. *First United Pentecostal Church of Beaumont v. Parker*, 514 S.W.3d 214 (Tex. 2017). The court explained:

> An actionable civil conspiracy requires specific intent to agree to accomplish something unlawful or to accomplish something lawful by unlawful means. This inherently requires a meeting of the minds on the object or course of action. Thus, an actionable civil conspiracy exists only as to those parties who are aware of the intended harm or proposed wrongful conduct at the outset of the combination or agreement.

Id.

In the *First United Pentecostal Church* case, the Texas Supreme Court did appear to clear up one important issue dealing with causation. *Id*. Before First United Pentecostal Church, there was confusion as to whether a finding of conspiracy (or aiding and abetting or knowing participation) automatically imposes joint liability on all defendants for all damages. Most of the cases seemed to indicate that a separate damage finding was necessary for each defendant because the conspiracy may not proximately cause the same damages as the original bad act. *See THPD, Inc. v. Continental Imports, Inc*., 260 S.W.3d 593 (Tex. App.—Austin 2008, no pet.); *Bunton v. Bentley,* 176 SW.3d 1 (Tex. App.—Tyler 1999), *aff'd in part, rev'd in part on other grounds,* 914 S.W.3d 561 (Tex. 2002); *Belz v. Belz*, 667 S.W.2d 240 (Tex. App.—Dallas 1984, writ ref'd n.r.e.). In *First United Pentecostal Church*, the Court held that the conspiracy defendant's actions must cause the damages awarded against it, and a plaintiff cannot solely rely on just the original bad actor's conduct. *First United Pentecostal Church of Beaumont v. Parker*, 514 S.W.3d at 214. So, there should be a finding of causation and damages for each conspiracy defendant (unless the evidence proves as a matter of law that all conspiracy defendants were involved from the very beginning). For a great discussion of these forms of joint liability for breach of fiduciary duty, please see E. Link Beck, Joint and Several Liability, State Bar Of Texas, 10th Annual Fiduciary Litigation Course (2015).

4. <u>Conclusion</u>

There has been a great increase in the use of aiding-and-abetting breach of fiduciary duty, knowing participation in breach of fiduciary duty, and conspiracy claims in Texas over the past five years. As seen above, all of these claims at some level require that the target defendant have some "knowledge" of a fiduciary's breach of duty. Plaintiffs who engage in fiduciary litigation in the context of business divorces should consider the potential liability of other third parties who assist or participate in the fiduciary's bad acts.

XX. DISGORGEMENT AND FORFEITURE RELIEF

The basis of a fiduciary relationship is equity. *Texas Bank & Trust Co. v. Moore*, 595 S.W.2d 502 (Tex. 1980). When a fiduciary breaches its fiduciary duties, a trial court has the right to award legal and equitable damages. It is common for a plaintiff to not have any legal or actual damages, but that does not prevent a trial court from being able to fashion an equitable remedy to protect the fiduciary relationship that has been violated. A trial court may order that the fiduciary forfeit compensation otherwise earned, disgorge improper gains and profits, or disgorge other consideration related to the breach of duty. This section of the paper will discuss the equitable remedies of forfeiture and disgorgement available to a trial court to remedy a breach of fiduciary duty.[1]

Texas cases often use the terms interchangeably, but there may be a distinction between "disgorgement" of ill-gotten profit and "forfeiture" of agreed compensation. George Roach, *Texas Remedies in Equity for Breach of Fiduciary Duty: Disgorgement, Forfeiture, and Fracturing*, 45 ST. MARY'S L.J. 367, 372-73 (2014).

A. General Authority

The Texas Supreme Court has upheld equitable remedies for breach of fiduciary duty. *Burrow v. Arce*, 997 S.W.2d 229, 237-45 (Tex. 1999) (upholding remedy of forfeiture upon attorney's breach of fiduciary duty). For example, in *Kinzbach Tool Co. v. Corbett-Wallace Corp.,* the Texas Supreme Court stated the principle behind such remedies:

> It is beside the point for [Defendant] to say that [Plaintiff] suffered no damages because it received full value for what it has paid and agreed to pay. . . . It would be a dangerous precedent for us to say that unless some affirmative loss can be shown, the person who has violated his fiduciary relationship with another may hold on to any secret gain or benefit he may have thereby acquired. It is the law that in

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[1]The equitable relief of disgorgement and forfeiture only apply for breach of fiduciary or confidential relationships. *Double Diamond-Delaware, Inc. v. Alfonso,* No. 05-18-01063-CV, 2020 Tex. App. LEXIS 5848 (Tex. App.—Dallas July 27, 2020, no pet. history).

> such instances if the fiduciary "takes any gift, gratuity, or benefit in violation of his duty, or acquires any interest adverse to his principal, without a full disclosure, it is a betrayal of his trust and a breach of confidence, and he must account to his principal for all he has received."

138 Tex. 565, 160 S.W.2d 509, 514 (Tex. 1942) (quoting *United States v. Carter*, 217 U.S. 286, 306, 30 S. Ct. 515, 54 L. Ed. 769 (1910)). The Court later held that a fiduciary may be punished for breaching his duty: "The main purpose of forfeiture is not to compensate an injured principal . . . . Rather, the central purpose . . . is to protect relationships of trust by discouraging agents' disloyalty." *Burrow*, 997 S.W.2d at 238.

For instance, courts may disgorge all profits from a fiduciary when a fiduciary agent usurps an opportunity properly belonging to a principal, or competes with a principal. *See, e.g., Johnson v. Brewer & Pritchard, P.C.*, 73 S.W.3d 193, 200 (Tex. 2002) (stating the rule that courts may disgorge any profit where "an agent diverted an opportunity from the principal or engaged in competition with the principal, [and] the agent or an entity controlled by the agent profited or benefitted in some way"). A fiduciary may also be required to forfeit compensation for the fiduciary's work. *See, e.g., Burrow*, 997 S.W.2d at 237 ("[A] person who renders service to another in a relationship of trust may be denied compensation for his service if he breaches that trust.").

B. Compensation Forfeiture

1. <u>General Authority</u>

When a plaintiff establishes that a fiduciary has breached its duty, a court may order the fiduciary to forfeit compensation that it was paid or should be paid. Under the equitable remedy of forfeiture, a person who renders service to another in a relationship of trust may be denied compensation for her service if he breaches that trust. *Burrow*, 997 S.W.2d at 237. The objective of the remedy is to return to the principal the value of what the principal paid because the principal did not receive the trust or loyalty from the other party. *Id*. at 237-38; *McCullough v. Scarbrough, Medlin & Assocs., Inc.*, 435 S.W.3d 871, 904 (Tex. App.—Dallas 2014, pet. denied). The party seeking forfeiture need not prove damages as a result of the breach of fiduciary duty. *Burrow*, 997 S.W.2d at 240; *Brock v. Brock*, No. 09-08-00474-CV, 2009 Tex. App. LEXIS 5444, at *5 (Tex. App.—Beaumont July 16, 2009, no pet.).

In *Burrow v. Arce*, former clients sued their attorneys alleging breach of fiduciary duty arising from settlement negotiations in a previous lawsuit. 997 S.W.2d at 232-33. The Texas Supreme Court held that "a client need not prove actual damages in order to obtain forfeiture of an attorney's fee for the attorney's breach of fiduciary duty to the client." *Id*. at 240. It repeated that "the central purpose of the remedy is to protect relationships of trust from an agent's disloyalty or other misconduct." *Id*. The Court cited section 469 of the Restatement (Second) of Agency, which states that if "conduct [that is a breach of his duty of loyalty] constitutes a wilful and deliberate breach of his contract of service, he is not entitled to compensation even for properly performed services for which no compensation is apportioned." *Id*. at 237. The Court also stated:

> [T]he possibility of forfeiture of compensation discourages an agent from taking personal advantage of his position of trust in every situation no matter the circumstances, whether the principal may be injured or not. The remedy of forfeiture removes any incentive for an agent to stray from his duty of loyalty based on the possibility that the principal will be unharmed or may have difficulty proving the existence or amount of damages.

Id. at 238.

Where equitable remedies exist, "the remedy of forfeiture must fit the circumstances presented." *Id*. at 241. The court has listed several factors for consideration when fashioning a particular equitable forfeiture remedy:

> "[T]he gravity and timing of the violation, its willfulness, its effect on the value of the lawyer's work for the client, any other threatened or actual harm to the client, and the adequacy of other remedies." These factors are to be considered in determining whether a violation is clear and serious, whether forfeiture of any fee should be required, and if so, what amount. The list is not exclusive. The several factors embrace broad considerations which must be weighed together and not mechanically applied. For example, the "willfulness" factor requires consideration of the attorney's culpability generally; it does not simply limit forfeiture to situations in which the attorney's breach of duty was intentional. The adequacy-of-other-remedies factor does not preclude forfeiture when a client can be fully compensated by damages. Even though the main purpose of the remedy is not to compensate the client, if other remedies do not afford the client full compensation for his damages, forfeiture may be considered for that purpose.

Id. at 243-44. Citing to comment c to section 243 of the Restatement (Second) of Trusts, the Court held:

> It is within the discretion of the court whether the trustee who has committed a breach of trust shall receive full compensation or whether his compensation shall be reduced or denied. In the exercise of the court's discretion the following factors are considered: (1) whether the trustee acted in good faith or not; (2) whether the breach of trust was intentional or negligent or without fault; (3) whether the breach of trust related to the management of the whole trust or related only to a part of the trust property; (4) whether or not the breach of trust occasioned any loss and whether if there has been a loss it has been made good by the trustee; (5) whether the trustee's services were of value to the trust.

Id. at 243. A party may seek forfeiture as a remedy for breach of a fiduciary duty, provided the party includes a request for forfeiture in its pleadings. *Lee v. Lee*, 47 S.W.3d 767, 780-81 (Tex. App.—Houston [14th Dist.] 2001, pet. denied); *Longaker v. Evans*, 32 S.W.3d 725, 733 n.2 (Tex. App.—San Antonio 2000, pet. withdrawn) (explaining that *Burrow v. Arce* did not apply where a party sought damages resulting from a fiduciary's misconduct and did not seek forfeiture).

The Supreme Court has held, "Ordinarily, forfeiture extends to all fees for the matter for which the [fiduciary] was retained." *Burrow*, 997 S.W.2d at 241 (quoting RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS, § 49 cmt. e); *see also Swinnea*, 318 S.W.3d at 873 ("[C]ourts may disgorge all ill-gotten profits from a fiduciary when a fiduciary agent usurps an opportunity properly belonging to a principal, or competes with a principal."). As an example of when total fee forfeiture is not appropriate, the Court has cited a circumstance such as "when a lawyer performed valuable services before the misconduct began, and the misconduct was not so grave as to require forfeiture of the fee for all services." *Burrow*, 997 S.W.2d at 241. It stated that "[s]ome violations are inadvertent or do not significantly harm the client" and can "be adequately dealt with by . . . a partial forfeiture." *Id*. (quoting RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS, § 49 cmt. b). Ultimately, fee forfeiture must be applied with discretion, based on all of the circumstances of the case. *Id*. at 241-42; *Swinnea*, 318 S.W.3d at 874-75.

So, a plaintiff who asserts a breach-of-fiduciary-duty claim may assert a claim that the defendant should forfeit its fees or compensation. The trial court should make that determination under the multiple-factor test based on the evidence in the case. The trial court can rule that the defendant should forfeit some, all, or none of the compensation. The remedy of forfeiture for a fiduciary's breach is dependent upon the facts and circumstances in each case. *See Burrow*, 997 S.W.2d at 241-42 ("Forfeiture of fees, however, is not justified in each instance in which a [fiduciary] violates a legal duty, nor is total forfeiture always appropriate.").

2. <u>Recent Cases</u>

In *Critical Path. Res., Inc., v. Huntsman Int'l, LLC*, an employer sued a turnaround manager (employee) for breach of fiduciary duty where the evidence supported the jury's finding that the employee used his influence to divert work to his friend's company and that the company billed the employer $1,100,000, of which $600,000 was for unauthorized items, and also diverted work to another company, from which the employee received $344,000. No. 09-17-99497-CV, 2020 Tex. App. LEXIS 2310 (Tex. App.—Beaumont March 19, 2020, no pet.). The court of appeals affirmed the trial court's forfeiture award of the employee's compensation. *Id*. The court stated:

> The Texas Supreme Court has recently explained that a remedy is available for a fiduciary's breach "even when the principal is not damaged." The Court explained: "It is the agent's disloyalty, not any resulting harm, that violates the fiduciary relationship and thus impairs the basis for compensation." The Court recognized that fee forfeiture, under circumstances that involved an attorney-client relationship, was appropriate. Thus, equity allows the factfinder to disgorge the fiduciary's salary when the fiduciary is guilty of breaching the duty of loyalty that he owed the plaintiff that sued him in the case.

Id.

In *Samuel D. Orbison & Am. Piping Inspection v. Ma-Tex Rope Co.*, a jury found that a former employee breached fiduciary duties by working for a competitor while being employed by the plaintiff. 553 S.W.3d 17 (Tex. App.—Texarkana June 15, 2018, no pet.). The court discussed the legal standards for forfeiture/disgorgement relief:

> When the court finds a breach of fiduciary duty, it may fashion an appropriate equitable remedy, including forfeiture of fees and disgorgement of any profit made at the expense of the employer. As the Texas Supreme Court noted, when an agent breaches his fiduciary duty, he is entitled to no compensation for conduct related to the breach, and if his breach is willful, "he is not entitled to compensation even for properly performed services." The main purpose of these equitable remedies "is not to compensate an injured principal," but rather "to protect relationships of trust by discouraging agents' disloyalty." Thus, a

> court "may disgorge all ill-gotten profits from a fiduciary when a fiduciary . . . usurps an opportunity properly belonging to a principal, or competes with a principal." It may also require the fiduciary to forfeit any compensation for his work paid by the principal.

Id. Regarding the application of these standards to the fact, the court sustained the trial court's award of a forfeiture of the compensation that the defendant was paid by the plaintiff and also a disgorgement of the compensation paid by the new employer to the defendant:

> Since the trial court found that Orbison breached his fiduciary duties to Ma-Tex, it had discretion to impose appropriate equitable remedies for the breach. Here, it elected to require forfeiture of a portion of the compensation paid by Ma-Tex to Orbison during the period of time that Orbison was assisting API to set up its recertification shop and was soliciting two of Ma-Tex's employee's to work for API. In addition, the trial court required disgorgement of an amount equal to the compensation paid by API to Orbison during the time that Orbison was actively competing with Ma-Tex by using Ma-Tex's confidential information to solicit its customers. Under Swinnea and the cases cited therein, we see no essential distinction between forfeiting a fee paid to an attorney or trustee who breaches his fiduciary duty and forfeiting the salary paid to an employee who does the same. In each instance the breaching fiduciary received compensation from the principal while breaching his trust. Neither do we see an essential distinction between disgorging a fee paid to, or the profit made by, an agent who usurps his principal's business opportunity and disgorging an amount equal to the salary paid to a former employee by his new employer when the former employee uses confidential information and trade secrets to solicit the customers of his former employer. In each instance, the breaching fiduciary profited by, or received compensation for, breaching the trust of his principal. The same principles apply to each of these circumstances, and the remedies of forfeiture and disgorgement are "necessary to prevent such abuses of trust." Consequently, we find that, under the circumstances of this case, Orbison was subject to the forfeiture of his salary paid by Ma-Tex and to the disgorgement of the salary paid to him by API while he was actively using Ma-Tex's confidential information to solicit its customers.

Id.

In *Cruz v. Ghani*, a limited partner sued a general partner over breach of fiduciary duty claims arising from, among other allegations, that the general partner should not have compensated himself from the business in addition to regular distributions. 2018 Tex. App. LEXIS 10318 (Tex. App.—Dallas Dec. 13, 2018, no pet.). The jury found that the general partner failed to comply with his fiduciary duties with respect to the payments made to himself, but awarded $0 in damages. The trial court did not award damages on this claim, and the limited partner appealed and argued the trial court should have entered judgment ordering disgorgement of the compensation.

The court of appeals first discussed the equitable remedies of disgorgement and forfeiture:

> Courts may fashion equitable remedies such as disgorgement and forfeiture to remedy a breach of a fiduciary duty. Disgorgement is an equitable forfeiture of benefits wrongfully obtained. A party may be required to forfeit benefits when a person rendering services to another in a relationship of trust breaches that trust… A claimant need not prove actual damages to succeed on a claim for forfeiture because they address different wrongs. In addition to serving as a deterrent, forfeiture can serve as restitution to a principal who did not receive the benefit of the bargain due to his agent's breach of fiduciary duty. However, forfeiture is not justified in every instance in which a fiduciary violates a legal duty because some violations are inadvertent or do not significantly harm the principal.
>
> Whether forfeiture should be imposed must be determined by the trial court based on the equity of the circumstances. However, certain matters may present fact issues for the jury to decide, such as whether or when the alleged misconduct occurred, the fiduciary's mental state and culpability, the value of the fiduciary's services, and the existence and amount of harm to the principal. Once the factual disputes have been resolved, the trial court must determine: (1) whether the fiduciary's conduct was a "clear and serious" breach of duty to the principal; (2) whether any monetary sum should be forfeited; and (3) if so, what the amount should be.

Id. The court noted that the jury found a breach of fiduciary duty, and that the limited partner sought "disgorgement/fee forfeiture" in his pleadings and argued for same at the hearing on a motion for judgment notwithstanding the verdict, but that the record did not show whether the trial court considered an equitable forfeiture award. The court held: "Because Cruz requested the remedy and it was timely brought to the trial court's attention, we conclude the request for equitable relief should be remanded to the trial court for consideration of the factors described by the Texas Supreme Court in *ERI Consulting Engineers, Inc. v. Swinnea,* 318 S.W.3d 867, 875 (Tex. 2010)." *Id*.

In *First United Pentecostal Church v. Parker*, the Texas Supreme Court reversed a summary judgment for an attorney and held that there was a fact question on whether the attorney benefited from a breach of fiduciary duty such that the trial court should allow fee forfeiture relief. 514 S.W.3d 214 (Tex. 2017). The court held that the elements of a claim for breach of fiduciary duty are (1) the existence of a fiduciary duty, (2) breach of the duty, (3) causation, and (4) damages. The court agreed in part with the client's argument that under *Kinzbach Tool Co. v. Corbett-Wallace Corp.,* 160 S.W.2d 509, 514 (Tex. 1942), that proof of damages was not required when the claim is that an attorney breached his fiduciary duty to a client and that the client need not produce evidence that the breach caused actual damages. The court held that when the client seeks equitable remedies such as fee forfeiture or disgorgement, that the client does not need to prove that the attorney's breach caused any damages.

In *Ramin' Corp. v. Wills,* an employer sued a former employee for breach of fiduciary duty and other claims based on the employee competing with the employer while she was an employee. No. 09-14-11168-CV, 2015 Tex. App. LEXIS 10612 (Tex. App.—Beaumont October 15, 2015, no pet.). The trial court found that the employee did breach her fiduciary duty, but held that the employer sustained no damages. The trial court also found for the employee on several of her counterclaims. Both parties appealed.

The court of appeals acknowledged that an employee does not owe an absolute duty of loyalty to her employer, and that absent an agreement to the contrary, an at-will employee may plan to compete with her employer, may take active steps to do so while still employed, may secretly join with other employees in a plan to compete with the employer, and has no general duty to disclose such plans. However, the at-will employee may not act for his future interests at the expense of his employer or engage in a course of conduct designed to hurt his employer.

One of the employer's arguments was that the trial court erred in not awarding a forfeiture of profits. The court of appeals first held that a party must plead for forfeiture relief and held that the employer had adequately done so. The court then addressed the merits of the argument. It held that under the equitable remedy of forfeiture, a person who renders service to another in a relationship of trust may be denied compensation for her service if she breaches that trust. The court further stated that the objective of the remedy is to return to the principal the value of what the principal paid because the principal did not receive the trust or loyalty from the other party. Disgorgement also involves a fiduciary turning over any improper profit that the fiduciary earned arising from a breach. The party seeking forfeiture and equitable disgorgement need not prove any damages as a result of the breach of fiduciary duty.

The court explained that a trial court has discretion in awarding disgorgement or forfeiture and may consider several factors, including (1) whether the agent acted in good faith; (2) whether the breach of trust was intentional or negligent or without fault; (3) whether the breach of trust related to the management of the whole or related only to a part of the principal's interest; (4) whether the breach of trust by the agent occasioned any loss to the principal and whether such loss has been satisfied by the agent, and (5) whether the services of the agent were of value to the principal. A court may also consider evidence of the fiduciary's salary, profits, or other income during the time the breach occurred.

The court affirmed the employer not receiving any disgorgement or forfeiture damages. The court held that there was evidence that the employee was not enriched by her activities: "we conclude that there is an absence of evidence to establish that Wills' breach of her fiduciary duty was directly connected to her recovery of overtime, or that Ramin incurred any loss resulting from Wills' breach, and there is no evidence that Wills' services she performed for Ramin during the overtime hours were of no value to Ramin." *Id*.

In *White v. Pottorff,* the court of appeals affirmed a compensation disgorgement where a manager breached fiduciary duties. 479 S.W.3d 409 (Tex. App.—Dallas August 18, 2015, pet. denied). The court stated:

> The trial court also ordered White to disgorge the $375,000 fee he received to manage WEIG. Appellants argue White should not be required to disgorge this sum because there is no evidence he received this fee as a result of any wrongdoing. A fiduciary may be required to forfeit the right to compensation for the fiduciary's work when he has violated his duty. Appellants do not challenge the trial court's finding that White breached his fiduciary duties with respect to the Scoular Transaction or in other non-Repurchase-related ways as found in Finding 175. Appellants only argue that White did not breach his fiduciary duties by failing to provide notice of Section 10.4 to WEIG and its members. Because the trial court concluded White breached his fiduciary duties with respect to the Scoular Transaction (and otherwise), the trial court did not err by ordering White to forfeit the $375,000 compensation he received for managing WEIG.

Id. at 419.

In *Dernick Res., Inc. v. Wilstein*, the court affirmed a fee disgorgement award in breach of fiduciary duty case arising from a joint venture. 471 S.W.3d 468, 495 (Tex. App.—Houston [1st Dist.] 2015, pet. denied). The court of appeals held:

> Whether a fee forfeiture should be imposed must be determined by the trial court based on the equity of the circumstances. However, certain matters—such as whether or when the alleged misconduct occurred, the fiduciary's mental state and culpability, the value of the fiduciary's services, and the existence and amount of harm to the principal—may present fact issues for the jury to decide. Once the factual disputes have been resolved, the trial court must determine whether the fiduciary's conduct was a clear and serious breach of duty to the principal, whether any of the fees should be forfeited, and if so, what the amount should be.

Id. at 482. The court of appeals noted that the issues in the appeal were narrow:

> The only question left to be answered was whether Dernick's breach of its fiduciary duty by seizing the opportunity to purchase the majority interest in the McCourt Field and appoint Pathex as operator was "clear and serious" so as to justify equitable fee forfeiture and, if so, what amount of fees should be forfeited. These are questions that are properly determined by the trial court.

Id. at 483. Among other facts, the court noted as follows:

> There was evidence that Dernick's breach of its fiduciary duty in failing to notify the Wilsteins in writing of the opportunity to make the Snyder acquisition, and its seizure of the opportunity to become majority owner and appoint the operator of the field, was not a single limited, "technical" failure arising from the parties' business practice, as Dernick argues. Rather, it was part of repeated conduct on Dernick's part that involved concealing or failing to disclose information it was required to disclose, using the Wilsteins' interest to enrich itself, and threatening further harm to the Wilsteins' interest in the field. Thus, there is evidence that the violation had repercussions that were felt by the Wilsteins over a period of years, from 1997 until the time of trial in 2013, and that it was willful.

Id. at 484. The court affirmed the disgorgement award. It also affirmed the award of prejudgment interest on the disgorgement award. *Id*.

Other recent cases have similarly affirmed fee forfeiture awards. *Gammon v. Henry I. Hank Hodes & Diag. Experts of Austin, Inc*., No. 03-13-00124-CV, 2015 Tex. App. LEXIS 4235 (Tex. App.— Austin Apr. 24, 2015, pet. denied); *McCullough v. Scarbrough, Medlin & Associates, Inc*., 435 S.W.3d 871, 912 (Tex. App.—Dallas 2014, pet. denied).

C. Disgorgement Of Profits Or Benefits

Disgorgement of profits or benefits is an equitable remedy appropriate when a party has breached his fiduciary duty; its purpose is to protect relationships of trust by discouraging disloyalty. *See, e.g., ERI Consulting Eng'rs, Inc. v. Swinnea*, 318 S.W.3d 867, 873 (Tex. 2010); *Burrow v. Arce*, 997 S.W.2d 229, 238 (Tex. 1999). Equitable disgorgement is a remedy for breach of trust in a fiduciary relationship. *See Sw. Energy Prod. Co. v. Berry-Helfand*, 491 S.W.3d 699, 729 (Tex. 2016). The Texas Supreme Court has noted that "we have not expressly limited the remedy to fiduciary relationships nor foreclosed equitable relief for breach of trust in other types of confidential relationships." *Id*.

Disgorgement of profits requires the fiduciary to yield to the beneficiary the profit or benefit gained during the time of the breach. *Int'l Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 576-77 (Tex. 1963); *AZZ Inc. v. Morgan*, 462 S.W.3d 284 (Tex. App.—Fort Worth Apr. 9, 2015, no pet.) (To obtain disgorgement, "proof of the fiduciary's salary, profits, or other income during the time of his breach of fiduciary duty is required[.]"); *Swinnea v. ERI Consulting Eng'rs, Inc*., 236 S.W.3d 825, 841 (Tex. App.—Tyler 2007), *rev'd on other grounds*, 318 S.W.3d 867 (Tex. 2010) ("[A] fiduciary must account for, and yield to the beneficiary, any profit he makes as a result of his breach of fiduciary duty[.]"); *Daniel v. Falcon Interest Realty Corp.*, 190 S.W.3d 177, 187 (Tex. App.—Houston [1st Dist.] 2005, no pet.) (same).

The fiduciary only has to disgorge "profits" and does not have disgorge net revenues. *Energy Co. v. Huff Energy Fund LP*, 533 S.W.3d 866 (Tex. 2017).

For example, in *Kinzbach Tool Co.*, a competitor of Kinzbach Tool Company ("Kinzbach") contacted a "trusted employee" of Kinzbach and offered the employee a secret commission if he would negotiate the sale of the competitor's product to Kinzbach for a minimum price. 160 S.W.2d at 510-11. The competitor instructed the employee not to reveal to Kinzbach the minimum price that the competitor was willing to accept. *Id*. During negotiations, the employee never revealed to Kinzbach, his employer, the minimum price the competitor was willing to accept, nor did he reveal his commission arrangement with the competitor. *Id*. After the deal was consummated, Kinzbach learned of the commission, fired the employee, and brought suit against the employee and the competitor. *Id*. In finding for Kinzbach, the Court stated:

> It is beside the point . . . to say that Kinzbach suffered no damages because it received full value for what it has paid and agreed to pay. A fiduciary cannot say to the one to whom he bears such relationship: You have sustained no loss by my misconduct in receiving a commission from a party opposite to you, and therefore you are without remedy. It would be a dangerous precedent for us to say that unless some affirmative loss can be shown, the person who has violated his fiduciary relationship with another may hold on to any secret gain or benefit he may have thereby acquired. It is the law that in such instances if the fiduciary takes any gift, gratuity, or benefit in violation of his duty, or acquires any interest adverse to his principal, without a full disclosure, it is a betrayal of his trust and a breach of confidence, and he must account to his principal for all he has received.

Id. at 514; *Siegrist v. O'Donnell*, 182 S.W.2d 403, 405 (Tex. Civ. App.—San Antonio 1944, writ ref'd) (holding that agent who agreed to accept $ 2,000 profit from person with whom he was dealing on behalf of his "unsuspecting principal" must disgorge that profit).

Disgorgement of profits is an independent remedy from damages, and the two are not assumed to be interchangeable. *Happy Endings Dog Rescue v. Gregory*, 501 S.W.3d 287, 293 (Tex. App.—Corpus Christi 2016, pet. denied). "Disgorgement is compensatory in the same sense attorney fees, interest, and costs are, but it is not damages." *Longview Energy*, 464 S.W.3d at 361; *see ERI Consulting Eng'rs, Inc. v. Swinnea*, 318 S.W.3d 867, 873 (Tex. 2010). The "universal rule for measuring damages for the breach of a contract is just compensation for the loss or damage actually sustained" by the party. *Adams v. H & H Meat Prods., Inc.*, 41 S.W.3d 762, 779 (Tex. App.—Corpus Christi 2001, no pet.). "By the operation of that rule a party generally should be awarded neither less nor more than his actual damages." *Adams*, 41 S.W.3d at 779. This is contrasted with disgorgement, which is properly measured by the defendant's unjust gains, not the plaintiff's loss. *Happy Endings Dog Rescue v. Gregory,* 501 S.W.3d at 293; *FTC v. Washington Data Res., Inc.*, 704 F.3d 1323, 1326 (11th Cir. 2013) (per curiam); *see Longview Energy,* 464 S.W.3d at 361.

"The primary objective of awarding damages in civil actions has always been to compensate the injured plaintiff, rather than to punish the defendant." *Smith v. Herco, Inc*., 900 S.W.2d 852, 861 (Tex. App.—Corpus Christi 1995, writ denied). By comparison, disgorgement is distinct from an award of actual damages in that the disgorgement award serves a separate function of deterring fiduciaries from exploiting their positions of confidence and trust. *Happy Endings Dog Rescue v. Gregory,* 501 S.W.3d at 293; *McCullough v. Scarbrough, Medlin & Assocs., Inc.*, 435 S.W.3d 871, 905 (Tex. App.—Dallas 2014, pet. denied). "Because of the strength of the harm principle ([i.e., to] avoid harming others), the ethical case for compensating for losses, whether or not they correspond to gains made by the tortfeasor, is generally thought to be stronger than that for requiring the disgorgement of gains which do not correspond to losses." *Happy Endings Dog Rescue v. Gregory*, 501 S.W.3d at 293 (quoting JAMES J. EDELMAN, UNJUST ENRICHMENT, RESTITUTION, & WRONGS, 79 Tex. L. Rev. 1869, 1876 (2001)).

Because of the different purposes of the awards, the one-satisfaction rule does not preclude the recovery of both actual damages and the equitable remedy of disgorgement, as these remedies are intended to address separate and distinct injuries. *Saden v. Smith*, 415 S.W.3d 450, 469 (Tex. App.—Houston [1st Dist.] 2013, pet. denied).

Disgorgement of profits requires the fiduciary to yield to the beneficiary the profit or benefit gained during the time of the breach. *AZZ Inc. v. Morgan*, 462 S.W.3d 284 (Tex. App.—Fort Worth Apr. 9, 2015, no pet.) (To obtain disgorgement, "proof of the fiduciary's salary, profits, or other income during the time of his breach of fiduciary duty is required[.]"); *Swinnea v. ERI Consulting Eng'rs, Inc.*, 236 S.W.3d 825, 841 (Tex. App.—Tyler 2007), *rev'd on other grounds,* 318 S.W.3d 867 (Tex. 2010) ("[A] fiduciary must account for, and yield to the beneficiary, any profit he makes *as a result of his breach* of fiduciary duty[.]") (emphasis added); *Daniel v. Falcon Interest Realty Corp.*, 190 S.W.3d 177, 187 (Tex. App.—Houston [1st Dist.] 2005, no pet.) (same) (citing to *Int'l Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 576-77 (Tex. 1963)). A defendant does not have to disgorge profits that were not related to its breach. *Id*.

A plaintiff asserting a breach of fiduciary duty claim can request that a trial court order the defendant to disgorge profits or benefits that were acquired by the defendant in relation to the breach of duty. *Johnson v. Brewer & Pritchard, PC*, 73 S.W.3d 193, 202 (Tex. 2002) (finding that an employee's wrongful receipt of a fee or compensation from a third party without the employer's consent must all be disgorged); *Int'l Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 577 (Tex. 1963) (affirming disgorgement of 100% of the directors' secret profits and the denial of any offsetting compensation). A recent law review article discusses the various cases that support the disgorgement of profits or gains. George Roach, *Texas Remedies in Equity for Breach of Fiduciary Duty: Disgorgement, Forfeiture, and Fracturing*, 45 ST. MARY'S L.J. 367, 372-73 (2014).

Additionally, a fiduciary has to disgorge any profit that it earned on the improperly obtained assets. For example, in *Nickel v. Bank of Am.*, 290 F.3d 1134 (9th Cir. 2002), a bank (later acquired by Bank of America) improperly charged $24,000,000 in fees to various trusts. The court of appeals found that the district court's focus on the "speculative" nature of the disgorgement in question was incorrect. *Id.* at 1138. The court found that focusing on questions of traceability simply insulated the wrongdoer, the bank, and violated a rule of restitution, namely "if you take my money and make money with it, your profit belongs to me." *Id*. The court also found that if the manner in which the bank had utilized the money was not traceable, there was a presumption that the bank was deriving profit from the funds. *Id.* Thus, an appropriate remedy was a proportional share of the bank's profits for the period the funds were utilized. *Id*. at 1139.

There may be underlying fact issues that should go to a jury, such as the amount of the profit or gain and how much of same was related to the breach of duty. *Energy Co. v. Huff Energy Fund LP*, 533 S.W.3d 866 (Tex. 2017) ("The amount of profit resulting from a breach of fiduciary duty will generally be a fact question."). For example, in *Longview*, the Texas Supreme Court reversed a trial court's award of profit disgorgement where the jury only found a revenue number and did not find the amount of profit made by the fiduciary defendant. *Id*.

In *Critical Path. Res., Inc., v. Huntsman Int'l, LLC*, an employer sued a turnaround manager (employee) for breach of fiduciary duty where the evidence supported the jury's finding that the employee used his influence to divert work to another company, from which the employee received $344,000. No. 09-17-99497-CV, 2020 Tex. App. LEXIS 2310 (Tex. App.—Beaumont March 19, 2020, no pet.). The court of appeals affirmed the trial court's disgorgement award of profits to the employee. *Id.* The court reviewed the jury's verdict as to the fact question as to how much profit the employee obtained, and affirmed that the evidence supported the finding and award. *Id*.

It should also be noted that the trial court should order a fiduciary defendant to disgorge all improper profits, and there does not have to be a weighing of factors to determine whether and how much should be disgorged as there does in compensation forfeiture cases. "It is the law that in such instances if the fiduciary 'takes any gift, gratuity, or benefit in violation of his duty, or acquires any interest adverse to his principal, without a full disclosure, it is a betrayal of his trust and a breach of confidence, and *he must account to his principal for all he has received*.'" *Kinzbach Tool Co. v. Corbett—Wallace Corp*., 138 Tex. 565, 160 S.W.2d 509, 514 (Tex. 1942) (emphasis added).

D. Contractual Consideration Disgorgement

A plaintiff can potentially seek the disgorgement of contractual consideration from a defendant. In *Swinnea v. ERI Consulting Engineers, Inc.*, Snodgrass and Swinnea owned equal interests in ERI, a small consulting company that managed asbestos abatement projects, for approximately ten years. 481 S.W.3d 747 (Tex. App.—Tyler 2016, no pet.). In August 2001, Snodgrass and ERI purchased Swinnea's interest in ERI for $497,500, after which Swinnea was to remain an ERI employee and not compete with ERI for six years. Prior to that time, Snodgrass and Swinnea had also been equal partners in Malmeba, which owned the building where ERI maintained its offices. As part of the buyout in August 2001, Snodgrass transferred his ownership interest in Malmeba, and ERI entered into a lease agreement for six years. Unbeknownst to Snodgrass, a month before the buyout, Swinnea's wife and the wife of another ERI employee created a new company called Air Quality Associates, which they used to bid on ERI administered asbestos abatement contracts despite having no prior experience in the asbestos abatement field. Swinnea did not disclose the existence of Air Quality Associates during the ERI buyout negotiations. After the buyout, Swinnea's revenue production decreased by 30%-50%. Swinnea subsequently learned of Snodgrass's involvement when one of ERI's biggest clients informed him and then stopped bidding on ERI's projects. The following year, in 2002, Swinnea's wife started a new abatement contracting company, Brady Environmental, Inc., which they told Snodgrass they would use for cleaning homes and air duct. Instead, Brady Environmental began performing asbestos abatement and competed with ERI. Swinnea continued to be employed by ERI, but the evidence showed he encouraged ERI's clients to use his company instead of ERI. ERI terminated Swinnea in June 2004. ERI and Snodgrass sued Swinnea and Brady Environmental for breach of fiduciary duty, breach of contract, and other related causes of action. After a bench trial, the trial court found for Snodgrass and ERI on the claims for statutory fraud, common law fraud, breach of the non-compete clause, and breach of fiduciary duty. It rendered judgment for ERI and Snodgrass for combined damages of $1,020,700 and $1 million in exemplary damages.

In the first appeal of that judgment, the court of appeals reversed and rendered judgment that ERI and Snodgrass take nothing. *Swinnea v. ERI Consulting Eng'rs, Inc.*, 236 S.W.3d 825 (Tex. App.—Tyler 2007), *rev'd*, 318 S.W.3d 867 (Tex. 2010). The Texas Supreme Court, however, reversed the court of appeals and remanded for consideration of the factors set forth in the Restatement (Second) of Trusts as to equitable forfeiture. *ERI Consulting Eng'rs, Inc. v.*

Swinnea, 318 S.W.3d 867 (Tex. 2010). The Court stated that the trial court should have considered certain factors in determining whether to order the disgorgement of contractual consideration:

> The gravity and timing of the breach of duty, the level of intent or fault, whether the principal received any benefit from the fiduciary despite the breach, the centrality of the breach to the scope of the fiduciary relationship, and any threatened or actual harm to the principal are relevant. Likewise, the adequacy of other remedies—including any punitive damages award—is also relevant. Above all, the remedy must fit the circumstances and work to serve the ultimate goal of protecting relationships of trust.
>
> There is no indication the trial court followed these principles in fashioning its award. Accordingly, we direct the court of appeals to remand the case to the trial court for consideration of these factors upon resolution of the issues remaining for the court of appeals

Id. On remand, the court of appeals remanded to the trial court for review of the forfeiture award as discussed in the Supreme Court's opinion. *Swinnea v. ERI Consulting Eng'rs, Inc.*, 364 S.W.3d 421 (Tex. App.—Tyler 2012, pet. denied).

The trial court entered judgment similar to the original judgment, awarding ERI and Snodgrass actual damages in the amount of $178,601, disgorgement in the amount of $720,700, and exemplary damages of $1 million. Swinnea appealed to the court of appeals, which affirmed that judgment. The court first rejected Swinnea's argument that the disgorgement award was punitive, recognizing that while forfeiture of contractual consideration may have a punitive effect, that is not the focus of the remedy, which is to protect relationships of trust by discouraging agents' disloyalty. 481 S.W.3d 747 (Tex. App.—Tyler 2016, no pet.). The court held that actual damages are not a prerequisite to disgorgement of contractual consideration; thus, it is not punitive. Awards of equitable disgorgement and exemplary damages are not duplicative. Additionally, mutual restitution (which would require ERI and Snodgrass to return the consideration they received in the August 2011 buyout) was not applicable because Snodgrass and ERI were not seeking rescission of the contract; rather, the remedy of disgorgement was in response to Swinnea's breach of fiduciary duty. Finally, as to one specific component of the award, the court held that the rental payments from ERI to Malmeba after the August 2001 buyout were properly disgorged. In short, the court held the trial court did not abuse its discretion in determining the remedy or amount of the disgorgement. *Id*.

More recently, in *Cooper v. Sanders H. Campbell/Richard T. Mullen, Inc.*, a company filed suit under a promissory note against a former joint venture partner. No. 05-15-00340-CV, 2016 Tex. App. LEXIS 9253 (Tex. App.—Dallas August 24, 2016, no pet.). The defendant filed a counterclaim for breach of fiduciary duty and sought equitable forfeiture for the amount owed under the note. The trial court initially awarded the plaintiff $1.4 million on the note, but later reduced that award by $520,000 for the equitable forfeiture claim. Both parties appealed.

The court of appeals affirmed the plaintiff's note claim, and then turned to the defendant's equitable forfeiture claim. The defendant argued that the trial court should have awarded an amount of forfeiture for the entire note claim, and not just a partial award. The plaintiff argued that the forfeiture award should be reversed because "the record does not show the trial court made the required determination that the conduct of the Mullen Co. was a 'clear and serious' breach of fiduciary duty, which the trial court can conclude only after applying the factors identified by the Texas Supreme Court." *Id*. (citing *ERI Consulting Eng'rs, Inc. v. Swinnea*, 318 S.W.3d 867, 874, 875 (Tex. 2010)). The court first set out the standards for equitable forfeiture:

> Courts may fashion equitable remedies such as disgorgement and forfeiture to remedy a breach of a fiduciary duty. Disgorgement is an equitable forfeiture of benefits wrongfully obtained. A party must plead forfeiture to be entitled to that equitable remedy. Whether a forfeiture should be imposed must be determined by the trial court based on the equity of the circumstances. However, certain matters may present fact issues for the jury to decide, such as whether or when the alleged misconduct occurred, the fiduciary's mental state and culpability, the value of the fiduciary's services, and the existence and amount of harm to the principal. Once the factual disputes have been resolved, the trial court must determine: (1) whether the fiduciary's conduct was a "clear and serious" breach of duty to the principal; (2) whether any monetary sum should be forfeited; and (3) if so, what the amount should be.
>
> As stated above, the trial court's first step is to determine whether there was a "clear and serious" breach of duty. The trial court should consider factors such as: (1) the gravity and timing of the breach; (2) the level of intent or fault; (3) whether the principal received any benefit from the fiduciary despite the breach; (4) the centrality of the breach to the scope of the fiduciary relationship; (5) any other threatened or actual harm to the principal; (6) the adequacy of other remedies; and (7) whether forfeiture fits the circumstances

> and will work to serve the ultimate goal of protecting relationships of trust. However, forfeiture is not justified in every instance in which a fiduciary violates a legal duty because some violations are inadvertent or do not significantly harm the principal.
>
> Second, the trial court must determine whether any monetary sum should be forfeited. The central purpose of forfeiture as an equitable remedy is not to compensate the injured principal, but to protect relationships of trust by discouraging disloyalty. Disgorgement is compensatory in the same sense as attorney fees, interest, and costs, but it is not damages. As a result, equitable forfeiture is distinguishable from an award of actual damages incurred as a result of a breach of fiduciary duty. In fact, a claimant need not prove actual damages to succeed on a claim for forfeiture because they address different wrongs. In addition to serving as a deterrent, forfeiture can serve as restitution to a principal who did not receive the benefit of the bargain due to his agent's breach of fiduciary duty. Third, if the trial court determines there should be a forfeiture, it must determine what the amount should be. The amount of disgorgement is based on the circumstances and is within the trial court's discretion. For example, it would be inequitable for an agent who performed extensive services faithfully to be denied all compensation if the misconduct was slight or inadvertent.

Id. (internal citations omitted).

The court then noted that the defendant did not plead for equitable forfeiture, though he did plead for breach of fiduciary duty and seek an award of damages. The defendant did not seek a jury finding on the plaintiff's mental state or culpability, the value of its services, or the existence and amount of harm to defendant. The jury found that the plaintiff breached its fiduciary duty to the defendant, but awarded him no damages. The defendant then asked the trial court to enter an award of forfeiture damages in his motion for judgment notwithstanding the verdict, and in other post-trial motions. However, the defendant did not adequately brief the issue and the factors relevant to such a claim. The court of appeals held that the record did not support the trial court's award, and remanded the case for further proceedings to allow the trial court to consider the appropriate legal standards, elements, and factors in finding that a forfeiture award should be entered:

> Cooper did not identify or brief in the trial court the requirement that the trial court conclude there was a "clear and serious" breach of duty as a predicate to assessing a sum that should be awarded as an equitable forfeiture. Cooper does not cite to anything in the record, nor can we find anything in the record, to show that in the fashioning of the equitable forfeiture award the trial court considered the "principles" or "factors" enumerated in *ERI Consulting*. Accordingly, we conclude the claim of forfeiture should be remanded to the trial court for consideration of the factors described by the Texas Supreme Court.

Id.

Where the facts and factors support it, a trial court may award disgorgement relief concerning a defendant's contractual consideration. However, a party seeking that relief should be careful that the record supports that relief and the trial court's consideration of same under the appropriate standards.

The court in *Haut v. Green Cafe Mgmt*., affirmed a trial court's disgorgement of the defendant's ownership interests in companies due to his breach of fiduciary duty. 376 S.W.3d 171, 183 (Tex. App.—Houston [14th Dist.] 2012, no pet.).

In *Michael D. Heatley v. Red Oak 86, L.P. & Charles Johnson,* investors in a limited partnership sued the managing member for breach of fiduciary duty. No. 05-18-01083-CV, 2020 Tex. App. LEXIS 6592 (Tex. App.—Dallas August 17, 2020, no pet.). The jury found that the defendants owed a fiduciary duty, breached the duty, but that the plaintiffs did not incur any damages. The trial court then, after trial, entered an award of equitable forfeiture and awarded the plaintiffs over $250,000, which accounted for the defendants' total contributions to the partnership. The defendants appealed.

The defendants argued that the plaintiffs waived any right to equitable forfeiture by failing to submit a question as to the level of the defendants' intent in breaching duties. The court of appeals first discussed equitable forfeiture:

> A trial court may order fee forfeiture as equitable relief when normal damages measures may not adequately address a breach of fiduciary duty. In ruling on a request for forfeiture, a trial court must determine three elements: [1] whether a "violation is clear and serious, [2] whether forfeiture of any fee should be required, and [3] if so, what amount." In making that determination, the court must consider non-exclusive factors: "[t]he gravity and timing of the breach of duty"; "the level of intent or fault"; "whether the principal received any benefit from the fiduciary despite the breach"; "the centrality of the breach to the

> scope of the fiduciary relationship"; "any threatened or actual harm to the principal"; "the adequacy of other remedies"; and "[a]bove all" whether "the remedy fit[s] the circumstances and work[s] to serve the ultimate goal of protecting relationships of trust." These "several factors embrace broad considerations which must be weighed together and not mechanically applied." Thus, for example, "the 'willfulness' factor requires consideration of the [fiduciary's] culpability generally; it does not simply limit forfeiture to situations in which the [fiduciary's] breach of duty was intentional." Nor would "the adequacy-of-other-remedies factor . . . preclude forfeiture in circumstances where the principal could be fully compensated by damages." The Heatley parties correctly note that, in the fee-forfeiture context, "when contested fact issues must be resolved before equitable relief can be determined, a party is entitled to have that resolution made by a jury." And "a dispute concerning an agent's culpability—whether he acted intentionally, with gross negligence, recklessly, or negligently, or was merely inadvertent—may present issues for a jury."

Id. (internal citations omitted). The court then looked to whether the defendants had preserved their complaint about the missing findings on intent. The court held that the plaintiffs had the burden to plead, prove, and obtain jury findings on fee forfeiture. The court held that the defendants waived their objection by failing to request any question on the plaintiff's claim or by failing to object to the omission.

The court then reviewed the evidence and determined that it was sufficient to support the trial court's forfeiture award. The court held that the evidence supported the trial court's finding that the breach was serious as the defendants failed to disclose information that went the heart of the investment and also disclosed that same information to other investors. The court held that even though the evidence was conflicting, it supported a finding of intentional conduct by the defendants. The court then held that the fact that the plaintiffs were not damaged and that the defendants did not obtain an improper benefit were not dispositive:

> This argument ignores a central tenet of forfeiture: "The main purpose of forfeiture is not to compensate an injured principal . . . . Rather, the central purpose is to protect relationships of trust by discouraging agents' disloyalty. . . . or other misconduct." A "client need not prove actual damages in order to obtain forfeiture" for breach of fiduciary duty. And, "even if a fiduciary does not obtain a benefit . . . by violating his duty, a fiduciary may be required to forfeit the right to compensation for the fiduciary's work." Forfeiture punishes a breach of fiduciary duty and exists as an equitable manner of compensating principals in situations where strict legal analysis does not support traditional measures of damages. The "threatened or actual harm to a principal" is only one relevant factor to be considered, while the most important consideration, "[a]bove all," is whether "the remedy . . . fit[s] the circumstances and work[s] to serve the ultimate goal of protecting relationships of trust.
>
> And, contrary to the Heatley parties' argument, the jury's refusal to find unjust enrichment cannot prevent forfeiture in this case. Here, unjust enrichment required the jury to find they acted intentionally; forfeiture, as we have noted, can be based on less than intentional conduct. In any event, the Heatley parties acquired interests adverse to their principals, Johnson and Red Oak, "without a full disclosure," a betrayal of "trust and a breach of confidence."

Id. The court also affirmed the trial court's award of joint and several liability between the defendants based on knowing participation in the breach. The court of appeals held that the fact that the plaintiffs failed to obtain any jury findings on knowing participation was not important. The trial court's judgment was affirmed.

XXI. ATTORNEY/CLIENT ISSUES

A. Attorney/Client Relationship

Certainly, an attorney can represent more than one party; in fact, that is very common. Persons in corporations often act in multiple capacities: individually, as an officer, as a director, and on behalf of the company. That individual can potentially have other relevant capacities: trustee, executor, power of attorney agent, etc. An attorney can represent the person in one capacity (preferred) or can represent them in multiple capacities (dangerous to do so).

For example, a law firm may represent both spouses in the sale of real property, the leasing of minerals, or in estate planning. *See, e.g., Estate of Arlitt v. Paterson*, 995 S.W.2d 713, 720–721 (Tex. App.—San Antonio 1999, pet. denied) (an attorney may represent a couple as joint estate planning clients, in which case the attorney will owe a duty to both clients). So, a reasonably prudent attorney should identify who he or she represents and clarify that he or she does not represent a party when the attorney first communicates with a party regarding a legal matter. *See* Tex. R. Disc. C. 4.03 ("In dealing on behalf of a client with a person who is not represented by counsel, a lawyer shall not state or imply that the lawyer is disinterested. When the lawyer knows or reasonably should know that the unrepresented person misunderstands the lawyer's role in the matter, the lawyer shall make reasonable efforts to correct the misunderstanding."). Though not dispositive, a "trier of fact may consider the construction of a relevant rule of professional conduct that is designed for the protection of persons in the claimant's position as evidence of the standard of care and breach of the standard." William V. Dorsaneo, TEXAS LITIGATION GUIDE, § 322.02 (Citing RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 52, cmt. f).

The downside of this issue for the attorney is that the attorney may inadvertently create an attorney-client relationship and be held to fiduciary duties that are not anticipated. To have an attorney-client relationship, there does not have to be a formal agreement. "While it is generally a relationship created by contract, an attorney-client relationship can be implied based on the conduct of the parties." *Sotello v. Stewart*, 281 S.W.3d 76, 80-81 (Tex. App.—El Paso 2008, pet. denied) (citing *Sutton v. Estate of McCormick*, 47 S.W.3d 179, 182 (Tex. App.—Corpus Christi 2001, no pet.) and *Mellon Service Co. v. Touche Ross & Co.*, 17 S.W.3d 432, 437 (Tex. App.—Houston [1st Dist.] 2000, no pet.)). "The attorney-client relationship may be implied if the parties by their conduct manifest an intent to create such a relationship." *Daves v. Commission For Lawyer Discipline*, 952 S.W.2d 573, 577 (Tex. App.—Amarillo 1997, pet. denied). For the relationship to be established, "the parties must explicitly or by their conduct manifest an intention to create it. To determine whether there was a meeting of the minds, we use an objective standard examining what the parties said and did and do not look at their subjective states of mind." *Roberts v. Healey*, 991 S.W.2d 873, 880 (Tex. App. —Houston [14th Dist.] 1999, pet. denied). "More specifically, an attorney-client relationship can be implied from the attorney's gratuitous rendition of professional services." *Sotello v. Stewart*, 281 S.W.3d at 80-81 (citing *Perez v. Kirk & Carrigan*, 822 S.W.2d 261, 265 (Tex. App.—Corpus Christi 1991, writ denied)).

In *Pennington v. Fields*, the majority of shareholders of a closely held business forced the buy-out of the minority shareholder and litigation ensued. No. 05-17-00321-CV, 2018 Tex. App. LEXIS 6601 (Tex. App.—Dallas August 21, 2018, no pet.). Later, the minority shareholder sued the majority shareholder's attorney and alleged that he committed legal malpractice by, among other things, negligently advising the majority to engage in oppression and breaches of fiduciary duties and that he failed to advise the minority shareholder to protect his interests against the misconduct of the majority. The attorney filed a motion for summary judgment, alleging that he owed the minority shareholder no fiduciary duty because he never represented him, which the trial court granted. The plaintiff appealed.

Regarding the existence of the attorney-client relationship, the court of appeals stated:

> The existence of a duty is an element of a legal malpractice claim. The attorney—client relationship is a contractual relationship that arises from a lawyer's agreement to render professional services to a client. The agreement may sometimes be implied from the parties' conduct. Id. at 292. But whether an agreement is express or implied, there must be evidence that both parties intended to create an attorney—client relationship. One party's subjective belief is insufficient to raise a question of fact to defeat summary judgment.

Id. (internal citations omitted). The plaintiff cited to two engagement letters between the company and the attorney, which referenced doing legal services as required the board of directors, of which the plaintiff was one at the time. The court of appeals held:

> These two agreements do not raise a fact issue regarding the existence of an attorney—client relationship between Pennington and Collins. Both agreements are between Advantage and Collins. A corporation is a legal entity separate and apart from the people who compose it, making it distinct from its stockholders, officers, and directors. Thus, rendering legal services to a corporation does not by itself create privity between the attorney and the corporation's officers, directors, or shareholders. We disagree with Pennington's argument that Collins was "clearly engaged to represent Advantage's shareholders," including Pennington. Pennington was not named in nor did he sign the agreement. The agreement was clearly between Collins and Advantage. Evidence of an agreement between Collins and Advantage is no evidence of an attorney—client relationship between Collins and one of Advantage's directors or shareholders.

Id.

The plaintiff then contended that there was an implied agreement for legal representation. The court stated:

> Although an attorney—client relationship may be implied from the actions of the parties, the parties must manifest an intention to create an attorney—client relationship. Whether there was a meeting of the minds must be based on an objective standard, examining what the parties did and said and not their alleged

> subjective states of mind… Both sides discuss the case of MacFarlane v. Nelson from the Third Court of Appeals. In that case, the court of appeals noted that when a lawyer represents a small entity with extensive common ownership and management, difficulties can arise in determining the existence of an attorney—client relationship. *MacFarlane v. Nelson*, No. 03-04-00488-CV, 2005 Tex. App. LEXIS 7681, 2005 WL 2240949, at *4 (Tex. App.—Austin Sept. 15, 2005, pet. denied) (mem. op.). The opinion listed several factors to consider in determining whether a lawyer for the entity also represents an individual owner: (1) whether the lawyer affirmatively assumed the duty of individual representation; (2) whether the owner had independent representation; (3) whether the lawyer previously represented the owner on a personal basis; (4) and whether the evidence demonstrates the owner's reliance on or expectations of the lawyer's separate representation. Id. An attorney—client relationship is not created with the individual owner simply because the owner discusses matters with the lawyer that are relevant to both the owner's and the entity's interests. *Id.*

Id. The plaintiff asserted that those factors weighed in favor of a finding that an attorney—client relationship existed, but the court disagreed:

> Pennington met Collins on the day he was removed as Advantage's president. Thus, Collins had not previously represented Pennington. Although Pennington did not have independent representation at that time, he retained his own legal counsel shortly after the June 27 meeting. Pennington asserts he believed Collins was "advising him and representing his interests" because Collins represented to Pennington that Pennington's interests were not adverse to Fields's and Phillips's. He contends Collins admitted he was representing all three directors. To demonstrate this, he relies on Collins's deposition testimony. In his deposition, Collins was asked if he thought he was helping Pennington. Collins stated he was trying to "find a solution for all of the parties to work together" and if it worked out, it would have helped Pennington. His goal was to help his clients, who were Fields and Phillips and later Advantage. Pennington's summary judgment evidence does not show that Collins affirmatively assumed a duty to represent Pennington individually. Evidence Pennington had a subjective belief that Collins was representing him is insufficient. Whether there was a meeting of the minds about representation must be based on an objective standard, and there is no objective evidence Collins intended to create an attorney—client relationship with Pennington. An attorney—client relationship was not created between Collins and Pennington simply because Collins discussed matters with Pennington that were relevant to both Pennington's and Advantage's interests.

Id. The court held that the evidence did not raise a fact issue regarding the existence of an attorney—client relationship and affirmed the summary judgment motions

It should also be noted that an attorney may be liable for not informing a party that it is not representing the party. *Querner v. Rindfuss*, 966 S.W.2d 661, 667-68 (Tex. App.—San Antonio 1998, writ denied) (recognizing that an attorney's advice may give rise to an informal fiduciary duty even when no formal attorney-client relationship is formed). The *Querner* court stated:

> Although an attorney hired by an executor generally represents the executor and not the beneficiary, an attorney for an executor may undertake to perform legal services as attorney for one or more beneficiaries. An attorney-client relationship may develop between the attorney retained by the executor and the beneficiaries either expressly or impliedly. Even absent an attorney-client relationship, an attorney may be held negligent for failing to advise a party that he is not representing the party. 'If circumstances lead a party to believe that they are represented by an attorney,' the attorney may be held liable for such a failure to advise.

Id.; see also Vinson & Elkins v. Moran, 946 S.W.2d 381 (Tex. App.—Houston [14th Dist.] 1997, pet. denied); *Burnap v. Linnartz*, 914 S.W.2d 142, 148 (Tex. App.—San Antonio 1995, writ denied).

So, to avoid confusion, the attorney should always have a written engagement letter that expressly identifies the client or clients, the attorney is not representing any other party not expressly mentioned, the scope of the engagement, and when the engagement will be terminated. Further, if appropriate, the attorney should follow up and orally tell those that he or she is not representing, but with whom the attorney often communicates, that he or she is not representing them and is only representing his or her client(s). Further, individuals should also seek clarification and ask an attorney who the attorney represents and whether the individual should retain his or her own attorney. Everyone should strive to be on the same page regarding who is the attorney and who is the client.

B. Attorney/Client Privilege

Confidential communications between client and counsel made to facilitate legal services are generally insulated from disclosure. See Tex. R. Evid. 503(b); I*n XL re XL Specialty Ins. Co.*, 373 S.W.3d 46, 49 (Tex. 2012) (orig. proceeding). A client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made to facilitate the rendition of professional legal services to the client: (A) between the client or the client's representative and the client's lawyer or the lawyer's representative; (B) between the client's lawyer and the lawyer's representative; (C) by the client, the client's representative, the client's lawyer, or the lawyer's representative to a lawyer representing another party in a pending action or that lawyer's representative, if the communications concern a matter of common interest in the pending action; (D) between the client's representatives or between the client and the client's representative; or (E) among lawyers and their representatives representing the same client. Tex. R. Evid. 503(b)(1).

This rule "promotes free discourse between attorney and client, which advances the effective administration of justice." *XL Specialty Ins. Co.*, 373 S.W.3d at 49; *Republic Ins. Co. v. Davis*, 856 S.W.2d 158, 160 (Tex. 1993).

Further, parties can jointly retain counsel and can jointly assert attorney-client privilege. The "joint client" or "co-client" doctrine applies in Texas "[w]hen the same attorney simultaneously represents two or more clients on the same matter." *Specialty Ins. Co*., 373 S.W.3d at 50. "Joint representation is permitted when all clients consent and there is no substantial risk that the lawyer's representation of one client would be materially adversely affected by the lawyer's duties to the other." *Id*. (citing 2 Restatement (Third) of the Law Governing Lawyers § 128 (2000)). "'Where [an] attorney acts as counsel for two parties, communications made to the attorney for the purpose of facilitating the rendition of legal services to the clients are privileged, except in a controversy between the clients.'" *Id*. (quoting *In re JDN Real Estate-McKinney L.P.*, 211 S.W.3d 907, 922 (Tex. App.—Dallas 2006, [mand. denied])). When more than one person seeks consultation with an attorney on a matter of common interest, the parties and the attorney may reasonably presume the parties are seeking representation of a common matter. *In re JDN Real Estate—McKinney L.P.*, 211 S.W.3d 907, 922 (Tex. App.—Dallas 2006, pet. denied).

So, when parties jointly retain counsel, their communications with their attorney are privileged as against third parties. However, if the parties themselves have a dispute, then there is no privilege and the communication between the attorney and either one of the clients is open to discovery by the other party. Tex. R. Evid. 503(d)(5) (noting that communications made by two or more clients to a lawyer retained in common are not privileged "when offered in an action between or among any of the clients"). Texas Rule of Evidence 503(d)(5) provides that the following is an exception to the privilege: "If the communication: (A) is offered in an action between clients who retained or consulted a lawyer in common; (B) was made by any of the clients to the lawyer; and (C) is relevant to a matter of common interest between the clients." Tex. R. Evid. 503(d)(5).

Often a minority shareholder and his or her attorney may want to communicate with another similarly situated minority shareholder. Generally, there should be extreme caution applied in this circumstance outside of litigation. Confidential communications to which the attorney-client privilege applies include those "by the client or a representative of the client, or the client's lawyer or a representative of the lawyer, to a lawyer or a representative of a lawyer representing another party to a pending action and concerning a matter of common interest therein[.]" Tex. R. Evid. 503(b)(1)(C). This rule, often referred to as the "common interest" privilege, is an exception to the general rule that no attorney-client privilege attaches to communications that are made in the presence of or disclosed to a third party. *In re JDN Real Estate—McKinney L.P*., 211 S.W.3d 907, 922-23 (Tex. App.—Dallas 2006, orig. proceeding [mandamus denied]). The Texas Supreme Court has addressed the "pending action" requirement of the rule and concluded that the "common interest" privilege is more accurately described as an "allied litigant" privilege. *In re XL Specialty Ins. Co.*, 373 S.W.3d 46, 52 (Tex. 2012) (orig. proceeding). This is because the privilege does not extend beyond litigation and it applies to any parties—not just the defendants—to a pending action. *Id*. "Because of the pending action requirement, no commonality of interest exists absent actual litigation." *Id.*

XXII. CONCLUSION

A minority shareholder's whole financial life can be invested in the business he or she partially owns and for whom he or she works. He or she can be dependent on employment with the business and the income that he or she earns. When the business relationship between the owners sours, the minority owner can be unceremoniously thrown out of the business. The majority owner may fire him or her, stop any compensation, refuse to make distributions/dividends, refuse to allow him or her to participate in the management of the business, refuse to provide information about the company, and refuse to allow him or her to transfer his or her shares and otherwise refuse to buy out the minority owner for a fair price. The majority owner may also inappropriately take company assets, take corporate opportunities, and otherwise deal unfairly with the business. The minority owner has rights, and the owner and his or her attorney must know the legal background of corporate and fiduciary law to obtain the best result. This article is intended to be a primer on many of those rights.