LLC MEMBER OPPRESSION AFTER *RITCHIE V. RUPE*

*Eric Fryar**

I. INTRODUCTION

This article explores a particular remedy for oppressive conduct against members of closely-held limited liability companies (LLCs) in the wake of the *Ritchie v. Rupe*[1] decision. The shareholder oppression doctrine was developed to protect minority shareholders in Texas closely-held corporations from abuses of power by majority shareholders and by the officers and directors they select. The shareholder oppression doctrine had two unique elements: First, the doctrine provided that controlling shareholders owed duties to minority shareholders not to "oppress"—meaning to defeat "reasonable expectations," which were either based on an express or implied agreement or were implied by law, or to commit egregious acts of bad faith and unfair dealing. Second, the doctrine provided equitable remedies for the violation of those duties, including a compulsory buy-out of the minority shareholder at a fair price determined by the court. The *Ritchie* decision abolished the shareholder oppression doctrine in Texas.[2] However, the Texas Supreme Court concluded that existing common law and statutory duties and remedies are "sufficient"[3] to protect the interests of minority shareholders—sufficient, but not ideal. The court conceded that "[their] conclusion leaves a 'gap' in the protection that the law affords to individual minority shareholders,"[4] and the possibility remains that a "proper case might justify [the] recognition of a new common-law cause of action to address a 'gap' in protection for minority shareholders."[5]

I have argued elsewhere that the reasoning in *Ritchie* allows, and even encourages, the development of existing common-law principles to fill the gap left by the *Ritchie* opinion.[6] I have argued for the enforcement of quasi-fiduciary duties that corporations owe to individual shareholders in a breach of trust cause of action, which would permit a buy-out remedy,[7] and for liberal application of the tort of conversion to stock in closely-held corporations for which the damages recoverable are the functional equivalent of a

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1. Ritchie v. Rupe, 443 S.W.3d 856 (Tex. 2014).
2. *Id.* at 891.
3. *Id.* at 888.
4. *Id.* at 889.
5. *Id.* at 890.
6. Eric Fryar, *Filling in the Gaps: Shareholder Oppression After* Ritchie v. Rupe: *Part 1*, 47:1 TEX. J. BUS. L. 49, 83–84 (2017) [hereinafter Fryar, *Part 1*].
7. *Id.* at 51.

buy-out.[8] In this article, I consider the shareholder oppression doctrine in the context of LLCs. I briefly examine the nature of LLCs, the phenomenon of shareholder oppression in closely-held corporations, and the corresponding phenomenon of minority member oppression in closely-held LLCs. I then recap the development of the shareholder oppression doctrine and its application to LLCs and describe the basis and implications of the *Ritchie* decision. Finally, I explore the viability of applying section 11.314 of the Texas Business Organizations Code (TBOC) to LLC member oppression—a statute not applicable to corporations[9] and not considered by the *Ritchie* court. I argue that Texas may still have a viable oppression cause of action for members of closely-held LLCs under section 11.314.[10]

In short, and as will be developed below, the shareholder oppression doctrine was grounded in section 11.404 of the TBOC. This statute provided for the appointment of a receiver and the possibility of liquidation if the actions of the governing persons were "illegal, oppressive, or fraudulent."[11] Texas courts developed a broad definition of "oppressive" that described a range of wrongful conduct in closely-held corporations. The courts invoked their general equitable powers to fashion appropriate remedies, including the compulsory buy-out of the oppressed shareholder's stock. The Texas Supreme Court held that the receivership statute did not provide a buy-out remedy and did not permit courts to use their equitable powers to fashion other remedies. However, there is a functionally similar statute that applies only to partnerships and LLCs that provides for winding up and termination of those entities.[12] This statute does not require a finding of oppression but instead provides relief for conduct and circumstances that either frustrate the economic purpose of the entity or make the carrying on of the business not reasonably practicable. Analysis of the text of the statute, of the few Texas cases dealing with the statute, and of the many cases from other jurisdictions interpreting similar text reveals that the statute applies to conduct and fact patterns that

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8. Eric Fryar, *Filling in the Gaps: Shareholder Oppression Aftter* Ritchie v. Rupe: *Part 2*, 47:2 TEX J. BUS. L. 1, 77 (2018), https://www.texasbusinesslaw.org/resources/texas-business-law-journal/volume-47-issue-no-2-spring-2018/filling-in-the-gaps-shareholder-oppression-after-ritchie-v-rupe-part-2.

9. *See* TEX. BUS. ORGS. CODE ANN. § 11.314 (West, Westlaw through 2017 Reg. Legis. Sess.). The statute is applicable only to limited liability companies and general and limited partnerships. *Id.*

10. I should point out that the common-law causes of action for breach of trust and conversion are almost certainly available in the limited liability company context, but that discussion is beyond the scope of this article.

11. BUS. ORGS. § 11.404–05 (Westlaw).

12. *See id.* § 11.314.

would have been considered oppressive under the shareholder oppression doctrine. Furthermore, the LLC statute is not limited to a single remedy and therefore permits courts to use their equitable powers to fashion an appropriate remedy—such as a compulsory buy-out.

II. TEXAS LIMITED LIABILITY COMPANIES

A. Nature of Limited Liability Companies

The limited liability company is a relatively new creation in business organizations law.[13] The LLC was designed to answer the need for a business entity that combined limited liability (like a corporation) with pass-through taxation (like a general or limited partnership).[14] Wyoming was the first state to effect a statute allowing the creation of LLCs, which passed in 1977.[15] Texas became one of only eight states to have recognized this new form of business organization, when the Texas Limited Liability Company Act[16] became effective on August 26, 1991.[17] By 1996, however, every U.S. jurisdiction had LLC statutes.[18] Texas LLC law is now codified in the TBOC, particularly chapter 101.[19] Texas remains committed to staying on the cutting edge of the development of LLC law.[20]

LLCs are attractive organizational vehicles for many types of closely-held businesses.[21] In less than three decades since its widespread adoption, the LLC has grown to be a more frequent choice of business organization than corporations, limited partnerships, and limited liability partnerships.[22]

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13. *See* Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L.J. 1459, 1459 (1998).

14. *See id.* at 1460.

15. *Id.*

16. Texas Limited Liability Company Act of 1992, TEX. REV. CIV. STAT. ANN. art. 1528n. (West, Westlaw through 2017 Reg. Legis. Sess.) (expired Jan. 1, 2010).

17. ELIZABETH S. MILLER & ROBERT A. RAGAZZO, 19 TEXAS PRACTICE SERIES, BUSINESS ORGANIZATIONS § 18:2 (Oct. 2018), Westlaw 19 TXPRAC § 18:2 [hereinafter MILLER & RAGAZZO, 19 TEXAS PRACTICE SERIES].

18. *Id.*

19. *See* TEX. BUS. ORGS. CODE ANN. § 101.001 (West, Westlaw through 2017 Reg. Legis. Sess.).

20. *See* MILLER & RAGAZZO, 19 TEXAS PRACTICE SERIES, *supra* note 17, § 18:5.

21. *Id.* § 18:2.

22. *Id.*

B. *Organizational Structure of LLCs*

The LLC is a hybrid entity, possessing both corporate and partnership features.[23] However, LLCs are distinct organizations and are neither corporations[24] nor partnerships.[25] Like a corporation and unlike a partnership, an LLC may have one sole owner;[26] the members are not responsible for the debts and obligations of the company;[27] and the members may participate in management without losing limited liability.[28] Management of an LLC may be structured like a corporation, with managers functioning like directors of a corporation, or like a partnership in which the members manage the company directly without managers.[29] On the other hand, ownership of an LLC follows the partnership model, in that transferees of ownership interests do not become members with the rights of membership (primarily the right to vote) unless all other members consent.[30]

The most distinctive feature of the LLC business form is the company agreement. The LLC statute is designed to allow owners maximum flexibility in devising their own company structure and rules.[31] While the TBOC provides many norms and regulations, most are only default provisions, and virtually all of them are subject to modification in the company agreement.[32] As a result,

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23. *Id.* § 18:3.

24. *See* Alta Mesa Holdings, L.P. v. Ives, 488 S.W.3d 438, 453 (Tex. App. 14th 2016) (holding that attorney's fees are not recoverable against an LLC under section 38.001 of the Texas Civil Practice and Remedies Code because that provision permits recovery of attorney's fees from an individual or corporation and an LLC is not an individual or corporation); *see also* CBIF Ltd. P'ship v. TGI Friday's Inc., No. 05-15-00157-CV, 2017 WL 1455407, at *14 (Tex. App. 5th 2017).

25. *See* SJ Med. Ctr., L.L.C. v. Estahbanati, 418 S.W.3d 867, 874 (Tex. App. 14th 2013) (rejecting the LLC's argument that it should be considered a partnership for purposes of a provision of the Texas Health and Safety Code defining a "hospital district management contractor" as "a nonprofit corporation, partnership, or sole proprietorship that manages or operates a hospital or provides services under contract with a hospital district that was created by general or special law").

26. *See, e.g.*, TEX. BUS. ORGS. CODE ANN. § 101.001(1) (West, Westlaw through 2017 Reg. Legis. Sess.) ("A company agreement of a limited liability company having only one member is not unenforceable because only one person is a party to the company agreement.").

27. *Id.* § 101.114.

28. Limited partners are not liable for partnership obligations so long as they do not participate in management. BUS. ORGS. § 152.102 (Westlaw). However, active participation in management forfeits the limited liability protection. *See* Humphreys v. Med. Towers, Ltd., 893 F. Supp. 672, 688 (S.D. Tex. 1995), *aff'd* 100 F.3d 952 (5th Cir. 1996).

29. BUS. ORGS. § 101.251 (Westlaw).

30. *See id.* § 101.109.

31. *See id.* §§ 101.052, 101.252.

32. *Id.* § 101.054.

"[t]he LLC's model of contractual freedom is found in few other places in the world."[33]

C. *Governance Issues Unique to LLCs*

1. Governing Documents

The certificate of formation[34] and the company agreement are the governing documents of an LLC.[35] The certificate is required to state whether the LLC will be governed by its members or by designated managers.[36] The TBOC contemplates that the company agreement will set forth all matters relating to the governance of the LLC and the relations of its members;[37] however, anything that may be included in a company agreement may also be stated in the certificate.[38] In the event of a conflict between the certificate and the agreement, the certificate controls.[39]

The TBOC provides that all members must agree to the company agreement, and all members must agree to any amendment.[40] Similarly, any amendment or restatement of the certificate requires a unanimous vote of the members.[41] However, these requirements may be modified in the certificate or company agreement.[42] The TBOC provides that a single member LLC may execute an enforceable company agreement.[43] Persons who join the LLC as members after its inception are bound by the existing certificate and company agreement and are required to exercise diligence in obtaining and understanding the contents of the certificate and company agreement.[44]

There is no requirement that an LLC have a company agreement or that a company agreement cover all the possible

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33. William J. Carney, *Limited Liability Companies: Origins and Antecedents*, 66 U. COLO. L. REV. 855, 861 (1995).

34. BUS. ORGS. § 1.002(36) (Westlaw).

35. *Id.* § 101.052.

36. *Id.* § 3.010.

37. *See id.* §§ 101.052–.054; 101.252.

38. *Id.* § 101.051.

39. *Id.* § 101.052(d); *see also* Pinnacle Data Servs., Inc. v. Gillen, 104 S.W.3d 188, 195 (Tex. App. 6th 2003), *disapproved on other grounds by* Ritchie v. Rupe, 443 S.W.3d 856 (Tex. 2014).

40. BUS. ORGS. § 101.001(1); 101.053 (Westlaw).

41. *Id.* § 101.356.

42. *Id.* § 101.054.

43. *Id.* § 101.001(1).

44. *See Pinnacle Data Servs.*, 104 S.W.3d at 195 ("The terms set forth in the Regulations, Articles, and the TLLCA are not rendered inoperative because PDS failed to exercise diligence in obtaining a copy of the Articles before agreeing to their terms.").

topics.[45] If the LLC fails to execute a company agreement or fails to address a matter in the company agreement, the default provisions of the TBOC will supplement or even function as the company agreement.[46]

2. Member Management

Limited liability companies may be member-managed or manager-managed.[47] In a member-managed LLC, the members operate the business directly like in a partnership.[48] In a manager-managed LLC, the members elect managers who then run the business—similar to shareholders and directors in a corporation.[49] Significant confusion sometimes exists in member-managed LLCs because the members in such an organization are also the governing persons with all the rights, powers, and liability that accompany that responsibility.[50] For example, under the TBOC, the rights of members to inspect company records are somewhat limited;[51] however, when the members are also governing persons, they have virtually unlimited information rights.[52] Individual members in a manager-managed LLC probably owe no duties to the company; however, when the members manage the LLC, they almost certainly do.

3. Voting

Another area that can cause significant confusion is voting. Under the default provisions of the TBOC, every member and every manager has an equal vote.[53] This may be changed in the certificate or company agreement,[54] but it is often overlooked. Therefore, a two-member, member-managed LLC may find itself hopelessly deadlocked, even when one member owns 90% of the equity and the other member owns only 10%.

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45. *Cf.* Advanced Orthopedics, L.L.C. v. Moon, 656 So. 2d 1103, 1105–06 (La. Ct. App. 1995) (stating there is no requirement under the Louisiana LLC statute that an LLC have an operating agreement—the equivalent to a company agreement in Texas—to be viable).

46. BUS. ORGS. § 101.052(b) (Westlaw) ("To the extent that the company agreement of a limited liability company does not otherwise provide, this title and the provisions of Title 1 applicable to a limited liability company govern the internal affairs of the company.").

47. *Id.* § 101.251.

48. *Id.* § 1.002(35)(A).

49. *Id.*

50. *Id.* § 1.002(37).

51. *See id.* § 101.502.

52. *See id.* § 3.152.

53. *Id.* § 101.354.

54. *Id.* § 101.054.

4. Fiduciary Duties in an LLC

Texas courts generally hold that governing persons in an LLC owe fiduciary duties to the company in the same way that directors owe fiduciary duties to a corporation.[55] Generally, no fiduciary duties are owed by members of an LLC to each other.[56] However, some courts have recognized an informal fiduciary duty between manager-members who control the LLC and non-controlling members based on the controlling member's intimate knowledge of the company's affairs.[57] Moreover, one court has recognized a formal fiduciary duty owed by a majority member to a minority member in the limited circumstance of negotiating the redemption or purchase of the minority member's ownership.[58]

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55. *See* Pinnacle Data Servs., Inc. v. Gillen, 104 S.W.3d 188, 198–99 (Tex. App. 6th 2003) (The court hold that LLC managers owe fiduciary duties based on the "well established [principle] that the directors of a corporation stand in a fiduciary relationship to the corporation and its stockholders, and they are without authority to act in a matter in which a director's interest is adverse to that of the corporation."), *disapproved of on other grounds by* Ritchie v. Rupe, 443 S.W.3d 856 (Tex. 2014); *see also In re* Hardee, No. 11-60242, 2013 WL 1084494, at *9 (Bankr. E.D. Tex. Mar. 14, 2013) ("Though limited liability companies are not corporations in the strictest sense, and though Texas law implies, but does not explicitly state, that the fiduciary status of corporate officers and directors and the corresponding three broad duties of such corporate officers and directors—the duty of due care, loyalty, and obedience—applies to managers and/or members governing the activities of a limited liability company, the imposition of those duties upon the management of a limited liability company under Texas law is appropriate and warranted.").

56. Allen v. Devon Energy Holdings, L.L.C., 367 S.W.3d 355, 391 (Tex. App. 1st 2012) ("[W]e do not agree with Allen that Texas recognizes a broad formal fiduciary relationship between majority and minority shareholders in closely-held companies that would apply to every transaction among them. We therefore decline to recognize such a fiduciary duty between members of an LLC on this basis."); Vejara v. Levior Int'l, LLC, No. 04-11-00595-CV, 2012 WL 5354681, at *4 (Tex. App 4th. Oct. 31, 2012) ("Texas does not recognize a broad formal fiduciary relationship between majority and minority shareholders in closely-held companies.").

57. *Vejara*, 2012 WL 5354681, at *5 (holding that "Vejara's control and intimate knowledge of the company's affairs and plans gave rise to the existence of an informal fiduciary duty to Levior"); Guevara v. Lackner, 447 S.W.3d 566, 581 (Tex. App. 13th 2014) (The court reversed a summary judgment on breach of fiduciary duties against a majority member based on "intimate knowledge of L & L Importers' daily affairs and plans as reflected in the evidence before this Court. There is evidence that Dr. Guevara did not have such extensive knowledge of L & L Importers' operations; that he was not involved in the day-to-day operations of the company.").

58. *See Allen*, 367 S.W.3d at 395–96 ("We conclude that there is a formal fiduciary duty when (1) the alleged-fiduciary has a legal right of control and exercises that control by virtue of his status as the majority owner and sole member-manager of a closely-held LLC and (2) either purchases a minority shareholder's interest or causes the LLC to do so through a redemption when the result of the redemption is an increased ownership interest for the majority owner and sole manager.").

III. RISE AND FALL OF THE SHAREHOLDER OPPRESSION DOCTRINE[59]

A. Oppressive Conduct in Closely-Held Corporations

In a corporation, whoever votes the majority of the shares exercises total control over who runs the corporation.[60] These majority shareholders almost always vote themselves and their friends and family to the board of directors.[61] In closely-held corporations, where the number of shares and shareholders is small, majority ownership of shares by one person or a small group is the norm.[62] Minority shareholders in these corporations have only the amount of control over the corporation that the majority permits.

Closely-held corporations usually involve a small group of people working closely together often in stressful situations—with all the accompanying potential for interpersonal conflict and drama.[63] As the Texas Supreme Court noted in *Ritchie v. Rupe*: "Occasionally, things don't work out as planned: shareholders die, businesses struggle, relationships change, and disputes arise. When, as in this case, there is no shareholders' agreement, minority shareholders who lack both contractual rights and voting power may have no control over how those disputes are resolved."[64]

Shareholders in small companies usually work in the company. Most of their personal wealth is tied up in the company. They are dependent upon salary, distributions from the company, or both to make a living. When a dispute arises, the majority shareholder will often attempt to "squeeze out" the minority member.[65] The squeeze out usually begins with firing the minority shareholder and refusing to declare dividends so the minority shareholder gets no economic benefit from share ownership.[66] In a subchapter-S corporation, the minority shareholder may continue to owe taxes on corporate earnings, even though he receives nothing.[67] Usually, the majority shareholder also adds insult to injury by voting the minority shareholder out as a director, cutting

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59. *See generally* Fryar, *Part 1*, *supra* note 6, at 58–84.

60. *Id.* at 52–53.

61. *See* Douglas Moll, *Majority Rule Isn't What It Used To Be: Shareholder Oppression in Texas Close Corporations*, 63 TEX. B.J. 434, 436 n.4 (2000) [hereinafter Moll, *Majority Rule*].

62. *See id.* at 436.

63. *Id.*

64. Ritchie v. Rupe, 443 S.W.3d 856, 878–79 (Tex. 2014).

65. *Id.* at 894 (Guzman, J., dissenting).

66. *See* Moll, *Majority Rule*, *supra* note 61, at 436.

67. *See* Fryar, *Part 1*, *supra* note 6, at 188.

off access to information about the company, and refusing to hold shareholder meetings.[68]

The minority shareholder is trapped in an oppressive situation and will be forced to sell to the majority shareholder at a price dictated by the majority. If the minority does not sell, then he will be subject to a "freeze out," in which his share ownership is simply ignored as irrelevant.[69]

> [M]inority shareholders in closely-held corporations have 'no statutory right to exit the venture and receive a return of capital' like partners in a partnership do, and 'usually have no ability to sell their shares' like shareholders in a publicly-held corporation do . . . . Unhappy with the situation and unable to change it, [minority shareholders] are often unable to extract themselves from the business relationship, at least without financial loss.[70]

The frozen-out minority will receive no benefits, no information, and no opportunity to participate as a shareholder.

Oppressive conduct is effective in closely-held corporations because of majority rule and the absence of an exit.

> A wielding of this power by any group controlling a corporation may serve to destroy a stockholder's vital interests and expectations. As the stock of closely-held corporations generally is not readily salable, a minority shareholder at odds with management policies may be without either a voice in protecting his or her interests or any reasonable means of withdrawing his or her investment.[71]

The *Ritchie* court reasoned that shareholders may protect themselves by drafting shareholder agreements "that contain buy-sell, first refusal, or redemption provisions that reflect their mutual expectations and agreements."[72] However, shareholder agreements that address future problems not anticipated at the founding of the company are exceedingly rare. The dissenting opinion in *Ritchie* aptly noted: "From a relational standpoint, people enter closely-held businesses in the same manner as they enter marriage: optimistically and ill-prepared."[73] Owners of

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68. Douglas K. Moll, *Shareholder Oppression in Texas Close Corporations: Majority Rule (Still) Isn't What It Used to Be*, 9 HOUS. BUS. & TAX. L.J. 33, 36 (2008).

69. *See id.*

70. *Id.*

71. *In re* Kemp & Beatley, Inc., 473 N.E.2d 1173, 1179 (N.Y. 1984).

72. *Ritchie*, 443 S.W.3d at 871.

73. *Id.* at 894 (Guzman, J., dissenting) (quoting Charles W. Murdock, *The Evolution of Effective Remedies for Minority Shareholders and Its Impact Upon Valuation of Minority Shares*, 65 NOTRE DAME L. REV. 425, 426 (1990)).

closely-held corporations usually trust each other, at least at the outset of the venture, and regard contractual protection as unnecessary.[74]

Without legal protection, minority ownership in a closely-held corporation can become essentially a joke—in other words: "There are 51 shares . . . that are worth $250,000. There are 49 shares that are not worth a ____."[75] The Texas Supreme Court acknowledged: "Closely-held corporations have unique attributes that may justify different protections under the law."[76]

Prior to *Ritchie*, Texas courts had come to recognize that they must "take an especially broad view of the application of oppressive conduct to a closely-held corporation, where oppression may more easily be found," and must use their equitable powers to protect the minority shareholders who find themselves on the receiving end of a squeeze out.[77] The majority opinion in *Ritchie* also acknowledged:

> 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.[78]

B. Oppression in Limited Liability Companies

Minority owners in small limited liability companies may be oppressed in the same manner and for the same reasons as minority owners in corporations.[79] Manager-managed LLCs are

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74. Douglas K. Moll, *Minority Oppression & the Limited Liability Company: Learning (or Not) from Close Corporation History*, 40 WAKE FOREST L. REV. 883, 912 (2005) [hereinafter Moll, *Minority Oppression*].

75. Humphrys v. Winous Co., 133 N.E.2d 780, 783 (Ohio 1956).

76. *Ritchie*, 443 S.W.3d at 864 n.8.

77. *See* Davis v. Sheerin, 754 S.W.2d 375, 381 (Tex. App. 1st 1988).

78. *Ritchie*, 443 S.W.3d at 879.

79. *See generally* Moll, *Minority Oppression*, *supra* note 74, at 895–96. Virtually all LLCs are closely held—meaning they have few members who are personally involved in running the company. *Id.* at 883. It is theoretically possible to have a publicly held LLC; currently, they are exceedingly rare. *Id.* at 925–26.

little different from corporations from an operational standpoint. Members have no management authority but elect managers to run the business, just like shareholders in a corporation vote for directors who run the business.[80] Usually, the person or group holding a majority ownership in an LLC will have control over the selection of managers.[81] In a member-managed LLC, majority members usually make sure they have management control.

Members of closely-held LLCs are vulnerable to oppression just as shareholders are vulnerable in closely-held corporations. Members in closely-held LLCs usually work together with a small number of other members, making interpersonal conflicts that may develop into ownership issues. Majority rule grants some members control over 100% of the management decisions. These members decide who to hire and fire, whether and how much to distribute, and who gets what information about the business. Majority members in closely-held LLCs have the same temptations to abuse that power. Finally, LLC members, like stockholders, ordinarily have no exit and thus, no ability to escape the trap of oppressive conduct other than to sell at an unfairly low price.[82] Professor Douglas Moll refers to these factors as the "seeds" of oppression[83] and notes that "the problem of oppression is 'portable' to the LLC context."[84]

Thus, majority LLC members have the ability to oppress minority members in exactly the same manner as in corporations. Members controlling the LLC might exclude the oppressed member from participation, cut off information, divert profits away from the minority member, and terminate the minority member's employment. Majority members can then use their economic leverage to squeeze out the minority member by forcing them to sell at an unfair price or to freeze them out by denying them all benefits of ownership and pretending they do not exist.

Minority members of LLCs are also just as able to protect themselves contractually as shareholders in a corporation—perhaps more so given the importance of the company agreement in LLC governance.[85] However, LLC members are just as trusting

80. *Id.* at 917–18.

81. *See id.* at 945–46 ("LLC statutes generally provide that a majority vote of the members is needed to elect (as well as to remove) a manager.").

82. TEX. BUS. ORGS. CODE ANN. § 101.107 (West, Westlaw through 2017 Reg. Legis. Sess.) ("A member of a limited liability company may not withdraw or be expelled from the company.").

83. Moll, *Minority Oppression*, *supra* note 74, at 956. "Although generalizations are dangerous due to the wide variety of LLC statutes, the "seeds" of oppression are, in many jurisdictions, present in the LLC setting." *Id.*

84. *Id.* at 896.

85. *See* BUS. ORGS. § 101.252 (Westlaw).

of their friends and family and are just as naïve as shareholders;[86] therefore, effective contractual protection against oppression is as rare in the LLC as it is in the corporation.

C. The Shareholder Oppression Doctrine

1. The "Oppression Statute"[87]

The so-called oppression statute is codified at section 11.404 of the TBOC. [88] This statute permits a district court to appoint a receiver at the request of an individual shareholder upon a showing that "the actions of the governing persons of the entity are illegal, oppressive or fraudulent."[89] Section 11.404(b)(3) prohibits appointing a receiver unless the court determines that all other available legal and equitable remedies are inadequate.[90] Significantly, the term "oppressive" is not defined, and the only remedy explicitly granted is a receivership—generally considered a drastic or harsh remedy and seldom to be used.[91] Prior to *Ritchie*, very little case law existed interpreting this statute.

2. Shareholder Oppression Cause of Action

In the 1980s, Texas courts began drawing on case law and statutory developments in other jurisdictions to fashion a new cause of action for shareholder oppression.

a. *Davis v. Sheerin*

The Houston case, *Davis v. Sheerin* was the first Texas case to recognize and attempt a systematic formulation of a shareholder oppression cause of action.[92] One commentator noted that the *Davis* case had "earned a prime place in black-letter

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86. Moll, *Minority Oppression*, *supra* note 74, at 956. "In short, the factors that contribute to a failure to effectively contract for protection in the close corporation are likely to produce the same outcome in the LLC. Those factors stem primarily from the traits of small business owners and the small business setting itself, rather than from the characteristics of the legal structure that is used to conduct the business." *Id.*

87. Ritchie v. Rupe, 443 S.W.3d 856, 897–98 (Tex. 2014) (Guzman, J., dissenting).

88. *See id.* (The dissenting opinion in *Ritchie* repeatedly refers to Texas Business Organizations Code section 11.404 as the "Oppression Statute."). The majority correctly takes the dissent to task for this characterization of the receivership provision: "We note that what the dissent calls 'the oppression statute,' the Legislature refers to as a rehabilitative receivership statute, only one prong of which includes oppression as one of three types of conduct addressed in that prong." *Id.* at 889 n.57 (majority opinion).

89. BUS. ORGS. § 11.404(a)(1)(C) (Westlaw).

90. *Id.* § 11.404(b)(3).

91. *See* Balias v. Balias, Inc., 748 S.W.2d 253, 257 (Tex. App. 14th 1988); *see also* Texarkana Coll. Bowl, Inc. v. Phillips, 408 S.W.2d 537, 540 (Tex. Civ. App. 6th 1966).

92. *See* Davis v. Sheerin, 754 S.W.2d 375, 378–83 (Tex. App. 1st 1988).

corporations law"[93] and had influenced case law development in a number of other states.[94] The Texas Supreme Court acknowledged the case as the seminal Texas authority on shareholder oppression.[95]

Davis refused to allow Sheerin to inspect the books and records of the corporation, claiming that Sheerin was not a shareholder.[96] The jury found that Davis and his wife had conspired to deprive Sheerin of his stock ownership in the corporation; that Davis and his wife received "informal dividends" to the exclusion of Sheerin; and that Davis and his wife willfully breached fiduciary duties by "wast[ing] corporate funds" by payment of their legal fees in the dispute.[97] The jury found that the "fair value" of Sheerin's stock was $550,000.[98] The appellate court also noted that the corporation's attorney had written a letter regarding Davis' wish to avoid payment of dividends and that Davis and his wife noted in board meeting minutes that "Mr. Sheerin's opinions or actions would have no effect on the Board's deliberations."[99]

On the basis of these findings and the undisputed portions of the evidence, the Houston trial court held that the defendants committed shareholder oppression and ordered them to buy out Sheerin's stock for the fair value of $550,000.[100] On appeal, Davis challenged the buy-out order but did not challenge the valuation.[101] The First Court of Appeals of Texas affirmed.[102]

The principal issue on appeal was whether the buy-out remedy was available under Texas law.[103] The First Court of Appeals noted that oppressive conduct is prohibited by article 7.05(a)(1)(c)[104] of the Texas Business Corporations Act, but that

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93. James Dawson, Ritchie v. Rupe *and the Future of Shareholder Oppression*, 124 YALE L.J. FORUM 89, 90 (Oct. 20, 2014) (citing ROBERT W. HAMILTON & JONATHAN R. MACEY, CASES AND MATERALS ON CORPORATIONS, INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES 500–07 (9th ed. 2005)).

94. *See id.* at 89 (citing Baur v. Baur Farms, Inc., 780 N.W.2d 249 (Iowa Ct. App. 2010); Bedore v. Familian, 125 P.3d 1168, 1172 n.20 (Nev. 2006); Lien v. Lien, 674 N.W.2d 816, 825 (S.D. 2004)).

95. Ritchie v. Rupe, 443 S.W.3d 856, 865 (Tex. 2014).

96. *Davis*, 754 S.W.2d at 377. The lawsuit also involved claims arising from a separate real estate partnership, but those claims are not relevant to this discussion. *Id.*

97. *Id.* at 378.

98. *Id.* at 378–383. Sheerin did not challenge this finding on appeal. *Id.*

99. *Id.* at 382.

100. *Id.* at 378.

101. *Id.*

102. *Id.* at 383.

103. *Id.* at 379.

104. TEX. BUS. ORGS. CODE ANN. § 11.404(a)(1)(c) (West, Westlaw through 2017 Reg. Legis. Sess.).

the only statutory remedy was the appointment of a receiver.[105] The court also noted that no Texas case had ever ordered the remedy of a buy-out, but the court reasoned, based on authority in other jurisdictions[106] and on the holding of the Texas Supreme Court in *Patton v. Nicholas*,[107] that the court had the inherent equitable power to fashion a remedy for oppressive conduct, other than receivership or liquidation.[108] Therefore, the court held, "Texas courts, under their general equity power, may decree a 'buy-out' in an appropriate case where less harsh remedies are inadequate to protect the rights of the parties."[109]

Next, the court discussed what constituted oppressive conduct. The court noted that neither Texas statutory law nor common law provided a definition of oppression.[110] The court examined authority from other jurisdictions and adopted two different (but complimentary) definitions: First, "oppression should be deemed to arise only when the majority's conduct substantially defeats the expectations that objectively viewed were both reasonable under the circumstances and were central to the minority shareholder's decision to join the venture,"[111] and second, "burdensome, harsh and wrongful conduct, a lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members, or a visible departure from the standards of fair dealing and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely."[112] These alternative definitions were meant to be expansive and "to cover a multitude of situations dealing with improper conduct."[113] Oppressive conduct included denial of share

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105. *Davis*, 754 S.W.2d at 378.

106. *Id.* at 379 (citing the following cases: "Alaska Plastics, Inc. v. Coppock, 621 P.2d 270, 276–77 (Alaska 1980); Sauer v. Moffitt, 363 N.W.2d 269, 275 (Iowa Ct. App. 1984); McCauley v. Tom McCauley & Son, Inc., 724 P.2d 232, 244 (N.M. Ct. App.1986) (granting the option of liquidation or 'buy-out'); *In re* Wiedy's Furniture Clearance Center Co., 487 N.Y.S.2d 901, 904 ([N.Y. App. Div.] 1985); Delaney v. Georgia-Pacific Corp., 564 P.2d 277, 289 (Or. 1977)"). The *Davis* Court also looked to statutes providing for a buy-out remedy. *Id.* (citing: "ALASKA STAT. § 10.05.540(2) (1985); IOWA CODE § 496A.94 (Supp. 1988); N.M. STAT. ANN. § 53-16-16 (West Supp. 1987); N.Y. BUS. CORP. LAW § 1104-a (McKinney 1986); OR. REV. STAT. § 57.595 (1983)" and "CONN. GEN. STAT. ANN § 33-384 (West 1987); ILL. REV. STAT. ch. 32, para. 12.55 (Supp. 1988); MINN. STAT. ANN. § 302A.751 (West 1985); N.C. GEN. STAT. § 55-125.1 (1982); S.C. CODE ANN. § 33-21-155 (1987) . . . CAL. CORP. CODE § 2000 (West Supp. 1988); W. VA. CODE § 31-1-134 (1988).").

107. 279 S.W.2d 848, 857 (Tex. 1955).

108. *Davis*, 754 S.W.2d at 380.

109. *Id.* at 380.

110. *Id.* at 381.

111. *Id.* (citing *In re Wiedy's*, 487 N.Y.S.2d at 903).

112. *Id.* at 382 (citing Baker v. Commercial Body Builders, Inc., 507 P.2d 387, 393 (Or. 1973)).

113. *Id.* at 381.

ownership, the denial of a voice in corporate affairs, and willful breaches of fiduciary duties to the corporation,[114] together with more "typical 'squeeze-out' techniques used in closely-held corporations, e.g., . . . malicious suppression of dividends or excessive salaries."[115] The existence of oppressive acts was a jury question,[116] but whether those acts constituted a violation of the duty not to oppress was a question of law for the court, and no jury question on oppression was to be submitted.

As the doctrine developed, the duty imposed on majority shareholders was purely statutory and arose from the prohibition against oppressive acts by directors or those in control of the corporation.[117] This was a duty owed by the controlling shareholder directly to the minority shareholder, and a claim for violation of that duty was a claim brought directly by the shareholder in his individual capacity.[118]

Oppressive conduct could be proven in one of two ways: either by proof that the minority's reasonable expectations had been substantially defeated or that the conduct was so bad as to constitute "burdensome, harsh, or wrongful conduct."[119] Reasonable expectations were "the minority's expectations that, objectively viewed, were both reasonable under the circumstances and central to the minority shareholder's decision to join the venture."[120] A plaintiff could prove "specific expectations," which would be based on either an express agreement between minority shareholders and majority shareholders or one clearly implied by the facts, which required "proof of specific facts giving rise to the expectations in a particular case and a showing that the expectation was reasonable under the circumstances of the case as well as central to the minority shareholder's decision to join the venture."[121] "General expectations" were reasonable as a matter of law, and were recognized by the courts as expectations that arise from stock ownership; these expectations are common to all stockholders and require no proof.[122] While every case paid lip

114. *Id.* at 383.

115. *Id.* at 382.

116. *Id.* at 380.

117. *See* TEX. BUS. ORGS. CODE ANN. § 11.404(a)(1)(C) (West, Westlaw through 2017 Reg. Legis. Sess.). *See generally* Davis v. Sheerin, 754 S.W.2d 375, 381 (Tex. App. 1st 1988) (finding that article 7.05 of the Texas Business Corporations Act "provides a cause of action based on oppressive conduct").

118. *See Davis*, 754 S.W.2d at 381.

119. Boehringer v. Konkel, 404 S.W.3d 18, 25 (Tex. App. 1st 2013) (citing Willis v. Bydalek, 997 S.W.2d 798, 801 (Tex. App. 1st 1999)).

120. *Id.* at 26.

121. *Id.*

122. Ritchie v. Rupe, 339 S.W.3d 275, 291–92 (Tex. App. 5th 2011).

service to specific expectations, all the shareholder oppression cases based their holdings on the shareholders' general expectations. [123]

The most significant aspect of the shareholder oppression doctrine was the buy-out remedy. While the courts were free to fashion any appropriate remedy, almost all of them ordered a buy-out. The buy-out countered the vulnerability of minority shareholders to oppressive conduct by giving them a way to exit the venture and cash out their ownership. As the court in *Davis* wrote, "[a]ppellants' oppressive conduct, along with their attempts to purchase appellee's stock, are indications of their desire to gain total control of the corporation. That is exactly what a 'buy-out' will achieve."[124] In effect, the majority, through its oppressive conduct, had wrongfully taken the value of the minority's stock ownership. The shareholder oppression doctrine with its buy-out remedy merely forced the majority to pay a fair price for what it had wrongfully taken. In *Davis v. Sheerin*, the court held that "[a]n ordered 'buy-out' of stock at its fair value is an especially appropriate remedy in a closely-held corporation, where the oppressive acts of the majority are an attempt to 'squeeze out' the minority, who do not have a ready market for the corporation's shares, but are at the mercy of the majority."[125]

b. Application of Shareholder Oppression in LLCs

The shareholder oppression doctrine was applied to limited liability companies in two Texas appellate cases, discussed below. Neither opinion questioned the appropriateness or the applicability of a doctrine developed for corporations.

In *Pinnacle Data Services, Inc. v. Gillen*,[126] the court applied the shareholder oppression doctrine to a member-managed LLC in a cause of action it termed "member oppression."[127] The plaintiff alleged that the defendant committed member oppression "by wrongfully withholding profit distributions, firing Max and Morris Horton from MJCM, failing to inform PDS of company actions, and paying for their personal legal fees in this lawsuit with MJCM funds."[128] The court affirmed a no-evidence summary judgment

123. *Boehringer*, 404 S.W.3d at 26.

124. Davis v. Sheerin, 754 S.W.2d 375, 383 (Tex. App. 1st 1988).

125. *Id.* at 381.

126. 104 S.W.3d 188 (Tex. App. 6th 2003), *disapproved of by* Ritchie v. Rupe, 443 S.W.3d 856 (Tex. 2014).

127. *Id.* at 191 (citing Willis v. Bydalek, 997 S.W.2d 798, 801 (Tex. App. 1st 1999); *see also Davis*, 754 S.W.2d at 381–82.

128. *Id.* at 196.

against the plaintiff because the summary judgment record failed to raise a genuine issue of material fact as to any of the claims.[129]

In *Kohannim v. Katoli*, the El Paso Court of Appeals affirmed a judgment for what it termed "oppression" in favor of the assignee of an interest in an LLC.[130] The plaintiff was assigned her ex-husband's 50% ownership in an LLC in their divorce.[131] The assignment did not make the plaintiff a member,[132] but it did confer a property right,[133] which the court held entitled the plaintiff to assert an oppression claim.[134] The court held:

> A member oppression claim may exist when: (1) a majority shareholder's conduct substantially defeats the minority's expectations that objectively viewed, were both reasonable under the circumstances and central to the minority shareholder's decision to join the venture; or (2) burdensome, harsh, or wrongful conduct, a lack of probity and fair dealing in the company's affairs to the prejudice of some members, or a visible departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.[135]

The court of appeals ruled the evidence was sufficient to sustain a judgment for oppression based on the failure to make distributions where the defendant "paid himself $100,000 for management services that were not performed and failed to make any profit distributions to [plaintiff] even though more than $250,000 in undistributed profit had accumulated in the company's accounts."[136] The court stated: "We also agree with the trial court's conclusion that the established facts demonstrated [defendant] engaged in wrongful conduct and exhibited a lack of fair dealing in the company's affairs to the prejudice of [plaintiff]."[137] The judgment ordered the liquidation of the assets and provided that plaintiff would be paid more than 50% of the proceeds to compensate her for the loss of value caused by the defendant.[138]

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129. *Id.*

130. Kohannim v. Katoli, 440 S.W.3d 798, 812–13 (Tex. App. 6th 2013), *disapproved of by* Ritchie v. Rupe, 443 S.W.3d 856 (Tex. 2014).

131. *Id.* at 812–14.

132. TEX. BUS. ORGS. CODE ANN. § 101.108(b) (West, Westlaw through 2017 Reg. Legis. Sess.); *see also id.* § 101.109(b).

133. *Id.* § 101.106.

134. *Kohannim*, 440 S.W.3d at 812.

135. *Id.*

136. *Id.* at 813.

137. *Id.*

138. *Id.* at 806.

c. *Ritchie v. Rupe*

In *Ritchie v. Rupe*, the Texas Supreme Court completely rejected the shareholder oppression doctrine.[139] The court also expressly disapproved of the two cases[140] that previously recognized a cause of action for oppression in LLCs.[141]

The court first turned to the receivership statute as a source for the duties recognized by the shareholder oppression doctrine.[142] The court determined that the construction of article 7.05 was a question of law.[143] "To determine the meaning of 'oppressive' in the receivership statute, our text-based approach to statutory construction requires us to study the language of the specific provision at issue, within the context of the statute as a whole, endeavoring to give effect to every word, clause, and sentence."[144] The court focused particularly on the other statutory grounds for imposing a receiver, concluding that all of them involved a "serious threat to the well-being of the corporation," and held that "[w]e must construe 'illegal, oppressive, or fraudulent' . . . in a manner consistent with these types of situations."[145] The court rejected the two definitions of "oppressive" that had been developed by the intermediate courts under the shareholder oppression doctrine and concluded:

> Considering all of the indicators of the Legislature's intent, we conclude that a corporation's directors or managers engage in "oppressive" actions under former article 7.05 and section 11.404 when they abuse their authority over the corporation with the intent to harm the interests of one or more of the shareholders, in a manner that does not comport with the honest exercise of their business judgment, and by doing so create a serious risk of harm to the corporation.[146]

The Texas Supreme Court further held that a buy-out was not available under the receivership statute: "Former article 7.05 creates a single cause of action with a single remedy: an action for appointment of a rehabilitative receiver."[147] The court rejected the argument that the provision in the receivership statute, requiring

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139. Ritchie v. Rupe, 443 S.W.3d 856, 866 (Tex. 2014).

140. *Kohannim*, 440 S.W.3d at 812–13; Pinnacle Data Servs., Inc. v. Gillen, 104 S.W.3d 188, 196 (Tex. App. 6th 2003).

141. *See Ritchie*, 443 S.W.3d at 871 n.17.

142. *Id.* at 863.

143. *Id.* at 866.

144. *Id.* at 867.

145. *Id.* at 868.

146. *Id.* at 871.

147. *Id.* at 872.

the court to find that all other remedies available at law or in equity are inadequate, implies the authority to order other appropriate equitable relief—"[t]his provision is a restriction on the availability of receivership, not an expansion of the remedies that the statute authorizes."[148]

Next, the court turned to the question of whether an independent cause of action should be recognized in the common law for shareholder oppression.[149] The court held that such an inquiry requires "something akin to a cost-benefit analysis to assure that this expansion of liability is justified."[150] After a thorough discussion of the vulnerabilities of minority shareholders and the risks and harm caused by oppressive conduct, the court concluded 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."[151] However, that conclusion "does not end our analysis" because "[w]e must next consider the adequacy of remedies that already exist."[152]

The court then analyzed the existing remedies in each of five areas where oppressive conduct is most frequently present: denial of access to information,[153] withholding of dividends,[154] termination of employment,[155] misappropriation of corporate funds and opportunities,[156] and manipulation of stock values.[157] As to denial of information, the court noted that "[t]he Legislature has already dictated what rights of access a shareholder has to corporate books and records, and no party alleges that the Legislature's statutory scheme is inadequate to protect shareholders in closely held corporations from improper denial of access to corporate records."[158] As to termination of employment, "our commitment to the principles of at-will employment compels us to conclude that the opportunity to contract for any desired

148. *Id.*
149. *Id.* at 877–78.
150. *Id.* (citing Roberts v. Williamson, 111 S.W.3d 113, 118 (Tex. 2003)).
151. *Id.* at 879.
152. *Id.*
153. *Id.* at 882.
154. *Id.*
155. *Id.* at 885.
156. *Id.* at 886–87.
157. *Id.* at 887.
158. *Id.* at 888.

employment assurances is sufficient."[159] Misappropriation may be remedied through derivative claims based on "the duty of loyalty that officers and directors owe to the corporation specifically [that] prohibits them from misapplying corporate assets for their personal gain or wrongfully diverting corporate opportunities to themselves."[160] The court reasoned these derivative claims might also be available to remedy withholding or refusing to declare dividends, termination of employment, and manipulation of corporate share values—"all relate to business decisions that fall under the authority of a corporation's offices and directors. As such, they are subject to an officer or director's fiduciary duties to the corporation."[161] Ultimately, the court determined that "these legal duties are sufficient to protect the legitimate interests of a minority shareholder by protecting the well-being of the corporation."[162]

The court concluded: "There must be well-considered, even compelling grounds for changing the law so significantly . . . . We find no such necessity here, and therefore decline to recognize a common-law cause of action for 'shareholder oppression.'"[163]

3. Implications of *Ritchie*

a. Difficulties for minority owners going forward

The *Ritchie* opinion eliminated the duty that majority owners owed to the minority. *Ritchie* holds that an "officer or director has no duty to conduct the corporation's business in a manner that suits an individual shareholder's interests when those interests are not aligned with the interests of the corporation and the corporation's shareholders collectively."[164] To recover individually, "a stockholder must prove a personal cause of action and personal injury."[165]

Oppression is always directed at the minority owner, with the injury being suffered only incidentally by the company, if at all. The issue is not whether the minority owner has suffered personal injury but whether the minority owner has a personal cause of action.[166] The *Ritchie* court refused to "impos[e] a common-law duty on directors in closely held corporations not to take

159. *Id.* at 886.
160. *Id.* at 887.
161. *Id.* at 888.
162. *Id.*
163. *Id.* at 891.
164. *Id.* at 889.
165. Wingate v. Hajdik, 795 S.W.2d 717, 719 (Tex. 1990).
166. *See id.*

oppressive actions against an individual shareholder even if doing so is in the best interest of the corporation."[167] However, in an actual case of oppression, the best interests of the corporation do not motivate the oppressor and are not necessarily implicated one way or the other. The Texas Supreme Court did not adopt a rule that the best interests of the company trumps the best interests of the individual owner when the two are in conflict. Rather, the court held that the majority owner has "no duty"[168] to the minority owner, and thus eliminated the possibility of any personal cause of action, "even if [the oppressive conduct is] motivated by malice toward the stockholder individually."[169]

The buy-out remedy provided the minority shareholder with an exit when trapped in an oppressive situation. The holding in *Ritchie* eliminated this remedy for oppressed shareholders and members.[170] Although the court cited other legal remedies that remain available to deal with oppressive behavior, none provide the badly needed exit. As the dissent in *Ritchie* argued, "[n]o other existing remedy the court discusses adequately protects minority shareholders from such oppression."[171]

b. Example: *Boehringer v. Konkel*

To take a concrete example, *Boehringer v. Konkel* was the last significant shareholder oppression case to be decided prior to *Ritchie*.[172] *Boehringer* involved a closely-held, subchapter-S corporation, but the facts would be almost identical, had it been an LLC. Were the parties commencing their business relationship today, chances are the company would have been formed as an LLC.

Konkel owned 49.9% and Boehringer owned 50.1% of a chemical engineering company.[173] At the first shareholder meeting, both agreed that each of their salaries would be set at $60,000 annually and that Boehringer would act as president and Konkel as vice president.[174] Boehringer was also probably the sole director. As the success of the business increased, "the relationship between Konkel and Boehringer deteriorated."[175] For example,

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167. *Ritchie*, 443 S.W.3d at 889.

168. *Id.* at 888–89.

169. Schoellkopf v. Pledger, 739 S.W.2d 914, 919 (Tex. App. 5th. 1987).

170. *Ritchie*, 443 S.W.3d at 872 ("Former article 7.05 creates a single cause of action with a single remedy: an action for appointment of a rehabilitative receiver.").

171. *Id.* at 905 (Guzman, J., dissenting).

172. *See generally* Boehringer v. Konkel, 404 S.W.3d 18 (Tex. App. 1st 2013).

173. *Id.* at 22.

174. *Id.*

175. *Id.* at 23.

"Konkel made between ten and twenty requests for corporate records from between 2001 and 2009," which Boehringer ignored.[176]

"The situation reached its boiling point at the February 2, 2009 shareholder meeting," when Boehringer told Konkel that he was "going to make [Konkel's] fucking life miserable."[177] Following the meeting, "Boehringer sent a company-wide email stating that Konkel was no longer in management," and Konkel resigned shortly thereafter.[178] "Later, Konkel learned that Boehringer had secretly awarded himself a pay raise in late 2008," increasing his gross pay to $240,000 annually, compared to Konkel's $48,000.[179] Despite earnings that generated a tax liability to Konkel for 2008, Boehringer never distributed any profits.[180] On February 23, 2009, Konkel sued Boehringer for shareholder oppression.[181]

"The jury found that Boehringer had . . . used his position to award himself an excessive salary to Konkel's detriment" and wrongfully withheld dividends from Konkel in 2008.[182] The trial court held that "shareholder oppression occurred as a matter of law" and ordered that the corporation be liquidated, with proceeds split according to share ownership after all debts were subtracted.[183] The Texas First Court of Appeals affirmed.[184]

The *Ritchie* court specifically disapproved of the holding in *Boehringer*,[185] and there is no doubt that the result would have been different if the case had been tried post-*Ritchie*, notwithstanding the existing remedies that the *Ritchie* court held were "sufficient."[186] The appellate court in *Boehringer* held: "The doctrine of shareholder oppression protects the close corporation minority stockholder from the improper exercise of majority control."[187] The court noted that "[a]n expectation of annual compensation through employment cannot be said to be a general expectation held by all shareholders of a corporation,"[188] and that if Konkel were complaining about his own salary, he would be

176. *Id.*
177. *Id.*
178. *Id.*
179. *Id.*
180. *Id.* at 23–24.
181. *Id.* at 24.
182. *Id.*
183. *Id.*
184. *Id.* at 22.
185. Ritchie v. Rupe, 443 S.W.3d 856, 871 n.17 (Tex. 2014).
186. *Id.* at 888.
187. *Boehringer*, 404 S.W.3d at 25 (citing Moll, *Majority Rule*, *supra* note 61).
188. *Id.* at 29 (citing ARGO Data Res. Corp. v. Shagrithaya, 380 S.W.3d 249, 266 (Tex. App. 5th 2012)).

required "to provide proof of specific facts showing that his specific expectation of a certain level of compensation was reasonable under the circumstances and central to his decision" to invest; however, the court noted, "Konkel is not complaining about his own compensation, but that Boehringer's raising of his own salary was detrimental to Konkel."[189] The court further held that "[a]s a shareholder, Konkel had a general and reasonable expectation to have the right to proportionate participation in the earnings of the company," and that the "resolution from the first shareholder meeting" proved his "reasonable expectation that corporate monetary benefits would be divided equally."[190] The court reasoned that the evidence justified the finding that Boehringer had received "a de facto dividend to the exclusion of Konkel."[191]

The facts as a whole proved that Boehringer's intent was to use his power over the corporation to harm Konkel. The cutoff of dividends coupled with the increase in Boehringer's salary, each of which was probably defensible in isolation, were used "as a means of denying Konkel his proportionate participation in the company's earnings."[192] Under *Ritchie*, that motivation would have been irrelevant because Boehringer owed no duty to Konkel and Konkel had no remedy for the scheme to freeze him out.

Under *Ritchie*, Konkel would have had to bring derivative claims against Boehringer for excessive compensation and withholding of dividends. The legal issue would have been whether those decisions were in the best interest of the company, and both decisions would have been shielded by the business judgment rule.[193] The fact that Konkel suffered a tax liability from the failure to declare dividends would have been irrelevant because Boehringer's duty would have been solely to the corporation, and he would have had no duty to declare dividends to Konkel or to avoid imposing unnecessary tax liability. Konkel would almost certainly have lost on the merits, but if he had won, the remedy would have been damages for the year 2008 and perhaps an injunction to declare dividends. Konkel would have remained trapped in the corporation with a majority owner intent on making his life a living hell.

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189. *Id.*
190. *Id.* at 30.
191. *Id.* at 31.
192. *Id.*
193. *Id.* at 29.

c. . Legal Development Post-*Ritchie*

The Texas Supreme Court stated that numerous statutory and contractual protections and other common-law remedies currently exist to protect against oppressive conduct.[194] The court also stated that "we do not foreclose the possibility that a proper case might justify our recognition of a new common-law cause of action to address a 'gap' in protection for minority shareholders."[195] The court made it clear:

> [W]e have not abolished or even limited the remedies available under the common law or other statutes for the kinds of conduct that give rise to rehabilitative receivership actions, whether under the oppressive-actions prong or other prongs . . . . [T]he actions that give rise to oppressive-action receivership claims typically also give rise to common-law claims as well, opening the door to a wide array of legal and equitable remedies not available under the receivership statute alone. Those remedies, whether lesser or greater, are not displaced by the rehabilitative receivership statute, which merely adds another potential remedy available in extraordinary circumstances when lesser remedies are inadequate.[196]

One of the statutory protections that remains neither "abolished or even limited" by the *Ritchie* decision is section 11.314 of the TBOC, which is a dissolution statute applicable only to partnerships and LLCs.[197] This statute, particularly as it was expanded with respect to LLCs in 2017,[198] may serve as a powerful remedy to combat oppressive conduct against minority owners in an LLC.

IV. RESISTING MEMBER OPPRESSION UNDER SECTION 11.314

Section 11.314 provides:

> A district court in the county in which the registered office or principal place of business in this state of a domestic partnership or limited liability company is located has jurisdiction to order the winding up and termination of the domestic partnership or limited liability company on application by an owner of the partnership or limited liability company if the court determines that:
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> (1) the economic purpose of the entity is likely to be unreasonably frustrated;

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194. Ritchie v. Rupe, 443 S.W.3d 856, 879–80 (Tex. 2014).

195. *Id.* at 890.

196. *Id.* at 875 n.28.

197. TEX. BUS. ORGS. CODE § 11.314 (West, Westlaw through 2017 Reg. Legis. Sess.).

198. *Id.* § 11.314(b).

> (2) another owner has engaged in conduct relating to the entity's business that makes it not reasonably practicable to carry on the business with that owner; or
>
> (3) it is not reasonably practicable to carry on the entity's business in conformity with its governing documents.[199]

The statute provides that the company becomes subject to district court jurisdiction to order winding up and termination if a petitioning member satisfies one or more of three tests, which we will refer to as the "economic purpose test," the "owner conduct test," and the "reasonable practicability test."[200] The provision was significantly amended in 2017 to make the first two tests applicable to LLCs.[201] Prior to 2017, only the reasonable practicability test applied to LLCs.[202]

Professors Miller and Ragazzo have noted that opinions from other jurisdictions interpreting essentially the same language have held that judicially decreed dissolution is available in a variety of circumstances, including when the company is unable to carry on its business at a profit, when there is dissension or deadlock among the owners or managers, or when the controlling member has engaged in serious misconduct.[203] Professors O'Neal and Thompson commented that, as LLC law has moved toward more entity permanence, statutes providing for judicial dissolution have taken on a greater role in regulating LLCs.[204]

No Texas cases have applied section 11.314 to an LLC, and only a small number of cases apply the same statute to partnerships. However, courts in other jurisdictions have applied statutes with wording essentially identical to the three tests set forth in section 11.314 to a wide variety of circumstances. Each of

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199. *Id.*; *see also* Hill v. Hill, 460 S.W.3d 751, 757–58 (Tex. App. 5th 2015) ("A district court has jurisdiction to order the winding up and termination of a limited liability company if the court determines it is not reasonably practicable to carry on the entity's business in conformity with its governing documents.").

200. *See* CBIF Ltd. P'ship v. TGI Friday's Inc., No. 05-15-00157-CV, 2017 WL 1455407, at *9 (Tex. App. 5th Apr. 21, 2017) ("Section 11.314 of the Texas Business Organizations Code authorizes a district court to order the winding up and termination of a partnership 'if the court determines' that at least one-of-three exigent circumstances listed in the statute exists.").

201. BUS. ORGS. § 11.314 (Westlaw).

202. *See generally* S.B. No. 1317, 85th Reg. Leg. Sess. (Tex. 2017) (Westlaw) (amending TEX. BUS. ORGS. CODE ANN. § 11.314 (West 2017)) (amending section 11.314 to also apply the economic purpose test and the owner conduct test to LLCs, which previously only applied to partnerships).

203. *See* ELIZABETH S. MILLER & ROBERT A. RAGAZZO, 20 TEXAS PRACTICE SERIES, BUSINESS ORGANIZATIONS § 21:12 (Oct. 2018), Westlaw 20 TXPRAC § 21:12 [hereinafter MILLER & RAGAZZO, 20 TEXAS PRACTICE SERIES].

204. F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL & THOMPSON'S OPPRESSION OF MINORITY SHAREHOLDERS & LLC MEMBERS § 6:23 (May 2018), Westlaw OPPMINSH PREMAT.

the three tests has been used to provide a remedy to dissension among the owners and to squeeze-out and freeze-out fact patterns. Section 11.314 should provide meaningful relief and the possibility of a compulsory buy-out to oppressed members of Texas LLCs.

A. Reasonable Practicability Test

The reasonable practicability test stated in section 11.314(3) is whether "it is not reasonably practicable to carry on the entity's business in conformity with its governing documents."[205] Prior to the 2017 amendment, this was the only test that applied to LLCs. While Texas case law is sparse, almost every other jurisdiction either permits or requires winding up of LLCs when it is not reasonably practicable to carry on an LLC's business in conformity with its governing documents.[206]

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205. BUS. ORGS. § 11.314 (Westlaw).

206. *See* ALA. CODE § 10A-5A-7.01 (West, Westlaw through Act 2018-579); ARIZ. REV. STAT. ANN. § 29-785 (West, Westlaw through 2018 Reg. Legis. Sess.); ARK.CODE ANN. § 4-32-902 (West, Westlaw through 2018 Fiscal Sess. and 2nd Extraordinary Sess.); ANN. CAL. CORP. CODE § 17351 (West, Westlaw through ch. 1016 of 2018 Reg. Legis. Sess.); COLO. REV. STAT. ANN. § 7-80-810 (West, Westlaw through 2018 Reg. Legis. Sess.); CONN. GEN. STAT. ANN. § 34-267(4)–(5) (West, Westlaw through 2018 Reg. Legis. Sess.); DEL. CODE ANN. § 18-802 (West, Westlaw through 81 Laws 2018, chs. 200–450); D.C. CODE. ANN. § 29-807.01 (West, Westlaw through Oct. 11, 2018); FLA. STAT. ANN. § 605.0702 (West, Westlaw through 2018 Reg. Legis. Sess.); GA. CODE ANN. § 14-11-603 (West, Westlaw through 2018 Reg. Legis. Sess.); HAW. REV. STAT. ANN. § 428-801 (West, Westlaw through 2018 Reg. Legis. Sess.); IDAHO CODE ANN. § 30-25-701 (West, Westlaw through 2018 Reg. Legis. Sess.); 805 ILL. COMP. STAT. ANN. 180/35-1 (West, Westlaw through Pub. Acts effective Aug. 28, 2018, through P.A. 100-1114, of the 2018 Reg. Sess.); IND. CODE. ANN. § 23-18-9-2 (West, Westlaw through 2018 Reg. Legis. Sess.); IOWA CODE ANN. § 489.701(d)(2) (West, Westlaw through 2018 Reg. Legis. Sess.); KY. REV. STAT. ANN. § 275.290 (West, Westlaw through 2018 Reg. Legis. Sess.); LA. STAT. ANN. § 12:1335 (West, Westlaw through 2018 Reg. Legis. Sess.); ME. REV. STAT. ANN. tit. 31, § 1595 (West, Westlaw through ch. 417 of the 2017 2nd Reg. Sess. & Emergency Legis. through ch. 460 of the 2nd Spec. Sess. of the 128th Legis.); MD. CODE ANN., CORPS. & ASS'NS § 4A-903 (West, Westlaw through 2018 Reg. Legis. Sess.); MASS. GEN. LAWS ANN. ch. 156C § 44 (West, Westlaw through ch. 207, and secs. 19 and 21 of ch. 228 of the 2018 2nd Ann. Sess.); MICH. COMP. LAWS ANN. § 450.4802 (West, Westlaw through P.A. 2018, No. 341 of the 2018 Reg. Legis. Sess.); MISS. CODE ANN. § 79-29-803 (West, Westlaw through 2018 Reg. Legis. Sess.); MO. ANN. STAT. § 347.143 (West, Westlaw through the end of the 2019 2nd Reg. Sess. of the 99th Gen. Assemb., pending changes received from the Revisor of Statutes); MONT. CODE ANN. § 35-8-902 (West, Westlaw through 2017 Reg. Legis. Sess.); NEB. REV. STAT. ANN. § 21-147 (West, Westlaw through 2018 Reg. Legis. Sess.); NEV. REV. STAT. ANN. § 86-495 (West, Westlaw through 2017 Reg. Legis. Sess.); N.J. STAT. ANN. § 42:2C-48 (through L. 2018, c. 199 and J.R. No. 9); N.M. STAT. ANN. § 53-19-40 (West, Westlaw through 2018 Reg. Legis. Sess.); N.Y. LTD. LIAB. CO. LAW § 702 (McKinney, Westlaw through L.2018, chs. 1–321); N.C. GEN. STAT. ANN. § 57D-6-02 (West, Westlaw through 2018 Reg. Legis. Sess.); N.D. CENT. CODE ANN. § 10-32.1-50 (West, Westlaw through 2017 Reg. Legis. Sess.); OHIO REV. CODE ANN. § 1705.47 (West, Westlaw through 132nd Gen. Assemb.); OKLA. STAT. ANN. tit. 18, § 2038 (West, Westlaw through 2018 Reg. Legis. Sess.); OR. REV. STAT. ANN. § 63.661 (West, Westlaw through 2018 Reg. Legis. Sess.); 15 PA. STAT. AND CONS. STAT. ANN. § 8871 (West, Westlaw through 2018 Reg. Legis. Sess.); 7 R.I. GEN. LAWS ANN. § 7-16-47 (West, Westlaw through ch. 353 of the Jan. 2018 Sess.); S.C. CODE ANN. § 33-44-801 (West, Westlaw through 2018 Act No.

Texas courts interpreting the "reasonably practicable" language in the limited partnership context have held that the provision "is unambiguous, and the legislature's intent is clear; we therefore apply its plain and ordinary meaning."[207] The Colorado Court of Appeals interpreting identical language in the Colorado LLC statute[208] held: "Based on these common definitions, we conclude that to show that it is not reasonably practicable to carry on the business of an LLC, a party seeking a judicial dissolution must establish that the managers and members of the company are unable to pursue the purposes for which the company was formed in a reasonable, sensible, and feasible manner."[209] "Not reasonably practicable" to carry on the business does not mean impossible.[210] A Delaware court reasoned that "[d]issolution of an entity chartered for a broad business purpose remains possible upon a strong showing that a confluence of situationally specific adverse financial, market, product, managerial, or corporate

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266); S.D. CODIFIED LAWS § 47-34A-801 (West, Westlaw through 2018 Reg. Legis. Sess.); TENN. CODE ANN. § 48-249-617 (West, Westlaw through 2018 Reg. Legis. Sess.); UTAH CODE ANN. § 48-3a-701 (West, Westlaw through 2018 Second Spec. Sess.); VT STAT. ANN. tit. 11, § 4101 (West, Westlaw through acts of Adjourned Sess. of 2017–2018 Vt. Gen. Assemb. (2018) effective upon passage through Sept. 1, 2018, and through all acts of the First Spec. Sess. of Adjourned Sess. of 2017–2018 Vt. Gen. Assemb. (2018)); VA CODE ANN. § 13.1-1047 (West, Westlaw through Reg. Legis. Sess.); WASH. REV. CODE ANN. § 25.15.274 (West, Westlaw through 2018 Reg. Legis. Sess.); W. VA. CODE ANN. § 31B-8-801 (West, Westlaw through 2018 First Extraordinary Legis. Sess.); WIS. STAT. ANN. § 183.0902 (West, Westlaw through 2017 Act 367, published Apr. 18, 2018); WYO. STAT. ANN. § 17-29-701 (West, Westlaw through 2018 Budget Sess.).

207. Dunnagan v. Watson, 204 S.W.3d 30, 43 (Tex. App. 5th 2006).

208. COLO. REV. STAT. ANN. § 7-80-810 (West, Westlaw through 2018 Reg. Legis. Sess.) ("A limited liability company may be dissolved in a proceeding by or for a member or manager of the limited liability company if it is established that it is not reasonably practicable to carry on the business of the limited liability company in conformity with the operating agreement of said company.").

209. Gagne v. Gagne, 338 P.3d 1152, 1160 (Colo. App. 2014) (citing *Webster's Third New International Dictionary* 1892 (2002) and *Black's Law Dictionary* 1456 (10th ed. 2014), explaining that "reasonably" is commonly defined to mean "in a reasonable manner"; "reasonable" means "[f]air, proper, or moderate under the circumstances; sensible"; and "practicable," in turn, is commonly defined to mean, "reasonably capable of being accomplished; feasible in a particular situation." *Black's Law Dictionary*, at 1361; *see also Webster's Third New International Dictionary*, at 1780 (defining "practicable" as "possible to practice or perform," "capable of being put into practice, done, or accomplished," and "feasible")); *see also* Taki v. Hami, No. 219307, 2001 WL 672399, at *3 (Mich. App. May 4, 2001) (defining "reasonably practicable" in Michigan's Uniform Partnership Act to mean "capable of being done logically and in a reasonable, feasible manner").

210. *See* Venture Sales, LLC v. Perkins, 86 So. 3d 910, 914 (Miss. 2012) ("Generally, dissolution under this standard does not require that a company's purpose has been 'completely frustrated.'"); Fisk Ventures, LLC v. Segal, No. 3017-CC, 2009 WL 73957, at *3 (Del. Ch. Jan. 13, 2009), *aff'd*, 984 A.2d 124 (Del. 2009) ("there is no need to show that the purpose of the limited liability company has been 'completely frustrated.'"); *In re* 1545 Ocean Ave., LLC, 893 N.Y.S.2d 590, 598 (N.Y. App. Div. 2010) (the test is "whether it is 'reasonably practicable' to carry on the business of the [LLC], and not whether it is 'impossible'").

governance circumstances make it nihilistic for the entity to continue."[211]

Courts have considered a number of factors in determining reasonable practicability:

> These include, but are not limited to: (1) whether the management of the entity is unable or unwilling reasonably to permit or promote the purposes for which the company was formed; (2) whether a member or manager has engaged in misconduct; (3) whether the members have clearly reached an inability to work with one another to pursue the company's goals; (4) whether there is deadlock between the members; (5) whether the operating agreement provides a means of navigating around any such deadlock; (6) whether, due to the company's financial position, there is still a business to operate; and (7) whether continuing the company is financially feasible.[212] No one of these factors is necessarily dispositive. Nor must a court find that all of these factors have been established in order to conclude that it is no longer reasonably practicable for a business to continue operating.[213]

1. "Not Reasonably Practicable to Carry on Business"[214]

The reasonable practicability test has two operative concepts. The first is the practicability of carrying on the business, and the second is the practicability of doing so in conformity with the governing documents.[215] If an LLC is simply not able to carry on the business for which it was created, then it obviously cannot satisfy the reasonable practicability test. There are a number of reasons that business have been dissolved due to the inability to carry on their business.

a. Failure of Stated Purpose

Limited liability companies fail the reasonable practicability test if they were formed for a specific purpose and are then unable to pursue that purpose for some reason. Examples include a company formed for the purpose of operating TGI Friday's

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211. *In re* Arrow Inv. Advisors, LLC, No. 4091-VCS, 2009 WL 1101682, at *3 (Del. Ch. Apr. 23, 2009).

212. *Gagne*, 338 P.3d at 1160–61 (citing Lola Cars Int'l Ltd. v. Krohn Racing, LLC, Nos. 4479-VCN, 4886-VCN, 2010 WL 3314484, at *22 (Del. Ch. Aug. 2, 2010)); *In re* Cat Island Club, L.L.C., 94 So. 3d 75, 79–80 (La. Ct. App. 2012); *In re 1545 Ocean Ave.*, 893 N.Y.S.2d at 597–98.

213. *Gagne*, 338 P.3d at 1161; *see Lola Cars Int'l*, 2010 WL 3314484, at *22.

214. COLO. REV. STAT. ANN. § 7-80-810 (West, Westlaw through 2018 Reg. Legis. Sess.).

215. *Gagne*, 338 P.3d at 1160; *Cat Island Club*, 94 So. 3d at 79.

restaurants at DFW airport that loses its lease at the airport,[216] a company formed to operate a horse racing track that fails to obtain a racing license,[217] and a company formed to operate a professional hockey team that fails to obtain the franchise.[218] When a company "cannot effectively operate under the operating agreement to meet and achieve the purpose for which it was created," dissolution has been allowed.[219]

> While no definitive, widely accepted test or standard exists for determining "reasonable practicability," it is clear that when a limited liability company is not meeting the economic purpose for which it was established, dissolution is appropriate. In making this determination, we must first look to the company's operating agreement to determine the purpose for which the company was formed.[220]

Courts often look to an LLC's company agreement to determine the "purpose" of the business when determining whether an LLC should be dissolved under the reasonable practicability test.[221] However, this analysis is of limited utility for most companies in Texas because LLCs formed in Texas may state that they are formed for "any lawful purpose."[222]

b. Financial Failure

A more obvious example of a business that is not reasonably practicable to carry on is one that is failing financially. Courts have ordered dissolution under the reasonable practicability standard when the LLC "is financially unfeasible."[223] "Dissolution generally has been deemed appropriate . . . when the company is failing financially."[224] A business that is not financially viable will fail to achieve the purposes stated in its governing documents—no matter what they are.

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216. *See generally* CBIF Ltd. P'ship v. TGI Friday's Inc., No. 05-15-00157-CV, 2016 WL 7163849 (Tex. App. 5th Apr. 21, 2017).

217. *See generally* Dunnagan v. Watson, 204 S.W.3d 30 (Tex. App. 5th 2006).

218. *See generally* McConnell v. Hunt Sports Enter., 725 N.E.2d 1193 (Ohio Ct. App. 1999).

219. *In re* 1545 Ocean Ave., LLC, 893 N.Y.S.2d 590, 597 (N.Y. App. Div. 2010).

220. Venture Sales, LLC v. Perkins, 86 So.3d 910, 915 (Miss. 2012).

221. *In re* Arrow Inv. Advisors, LLC, No. 4091-VCS, 2009 WL 1101682, at *1 (Del. Ch. Apr. 23, 2009).

222. TEX. BUS. ORGS. CODE § 3.005(a)(3) (West, Westlaw through 2017 Reg. Legis. Sess.).

223. Mizrahi v. Cohen, 961 N.Y.S.2d 538, 541 (N.Y. App. Div. 2013).

224. *Venture Sales*, 86 So. 3d at 914–15.

c. Deadlock

Another reason that it is not reasonably practicable to carry on the business at all is when the company's decision-making capacity is deadlocked.[225] "[A] deadlocked management board is a quintessential example of a situation justifying a judicial dissolution."[226] Under Texas law, a deadlock can occur in an LLC any time there are an equal number of managers (or members in a member-managed company), and the company agreement does not provide for weighted voting or some tie-breaking mechanism.[227] Unless otherwise provided in the company agreement, "[e]ach governing person, member, or committee member of an LLC has an equal vote at a meeting of the governing authority, members, or committee of the company, as appropriate."[228] "[I]f that deadlock cannot be remedied through a legal mechanism set forth within the four corners of the operating agreement, dissolution becomes the only remedy available as a matter of law."[229]

Where the parties are able to resolve the deadlock by, for example, lawfully expelling a member or purchasing his interest, dissolution will be denied.[230] However, courts do not consider a deadlock to be resolved where one party has control as a practical matter and cannot be ousted because of the deadlock. As the Delaware Chancery Court has stated, "this court has rejected the

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225. *E.g.*, Hill v. Hill, 460 S.W.3d 751, 758 (Tex. App. 5th 2015) ("Hill Jr. and the receiver presented summary judgment evidence that Hill Jr. and Hill III were each 50% owners of the Company, but could not agree on the manner in which the Company would conduct business. The Company's organizational documents required a majority of the members to agree to conduct business.").

226. Vila v. BVWebTies LLC, No. 4308-VCS, 2010 WL 3866098, at *7 (Del. Ch. 2010); *see also* Fisk Ventures, LLC v. Segal, No. 3017-CC, 2009 WL 73957, at *4 (Del. Ch. 2009), *aff'd*, 984 A.2d 124 (Del. 2009) ("If a board deadlock prevents the limited liability company from operating or from furthering its stated business purpose, it is not reasonably practicable for the company to carry on its business."); Kirksey v. Grohmann, 754 N.W.2d 825, 831 (S.D. 2008) (dissolution appropriate where "sisters formed their company contemplating equal ownership and management, yet only an impenetrable deadlock prevails"); Haley v. Talcott, 864 A.2d 86, 88 (Del. Ch. 2004) ("[I]t is not reasonably practicable for the LLC to carry on business in conformity with a limited liability company agreement (the 'LLC Agreement') that calls for the LLC to be governed by its two members, when those members are in deadlock.").

227. BUS. ORGS. § 101.354 (Westlaw).

228. *Id.*

229. *Fisk Ventures*, 2009 WL 73957, at *7.

230. *See* Dunbar Group, LLC v. Tignor, 593 S.E.2d 216, 219 (Va. 2004) ("Although Tignor's actions in those capacities had created numerous problems in the operation of Xpert, his expulsion as a member changed his role from one of an active participant in the management of Xpert to the more passive role of an investor in the company. The record fails to show that after this change in the daily management of Xpert, it would not be reasonably practicable for Xpert to carry on its business pursuant to its operating authority.").

notion that one co-equal fiduciary may ignore the entity's governing agreement and declare himself the sole 'decider.'"[231]

2. "In Conformity with the Governing Documents"[232]

Section 11.314(3) modifies the concept of "not reasonably practicable to carry on the entity's business" with the phrase "in conformity with its governing documents."[233] Limited liability companies that cannot function at all because they are financially defunct, because they are unable to pursue the specific purpose for which they were formed, or because the company cannot function due to its management being hopelessly deadlocked, are easy cases. Some courts have effectively limited dissolution of LLCs under statutes similar to section 11.314 to those specific instances.[234] However, the plain language of section 11.314 demands a broader reading. The South Dakota Supreme Court noted: "There is no dispute that the ranching and livestock operation, as a business, can continue despite the sisters' dissension. However, the question is whether it is reasonably practicable for the company to continue *in accordance with* the operating agreement."[235]

A reading of the statute that limits its application to the question of whether the company is able to carry on its business at all would render the phrase "in conformity with its governing documents" superfluous. If review of the governing documents is limited to the stated purpose of the entity (which will almost

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231. *BVWebTies*, 2010 WL 3866098, at *8; *see also Kirksey*, 754 N.W.2d at 831 ("Leaving two sisters, half the owners, with all the power in the operation of the company cannot be a reasonable and practicable operation of a business. Moreover, their deadlock certainly impedes the continued function of the business in conformity with its operating agreement. No procedure exists in the company's documentation to break a tie vote and protect the company in the event of changed conditions. As long as the company remains in control of, and favorable only to, half its members, it cannot be said to be reasonably practicable for it to continue in accord with its operating agreement.").

232. BUS. ORGS. § 11.314(3) (Westlaw).

233. *Id.*

234. *See In re* 1545 Ocean Ave., LLC, 72 A.D.3d 121, 131 (N.Y. App. Div. 2010) ("After careful examination of the various factors considered in applying the "not reasonably practicable" standard, we hold that for dissolution of a limited liability company pursuant to LLCL 702, the petitioning member must establish, in the context of the terms of the operating agreement or articles of incorporation, that (1) the management of the entity is unable or unwilling to reasonably permit or promote the stated purpose of the entity to be realized or achieved, or (2) continuing the entity is financially unfeasible."); *see also* Hughes v. Cloonlara-Hughes Ltd. P'ship, No. 2-15-0715, 2016 WL 1569620, at *15 (Ill. App. 2016) ("Applying these principles here, summary judgment was properly granted on count V [dissolution], as the plaintiffs have not shown the existence of either (1) deadlock preventing the management from acting or (2) frustration of the partnership purpose.").

235. *Kirksey*, 754 N.W.2d at 830.

always be "any lawful purpose"),[236] then only the certificate of formation should be referenced, not the governing documents. The company agreement frequently does not address the company's purpose; the function of the company agreement is to govern the relations among the members, manager, and officers and other internal affairs of the company.[237] One can certainly envision situations in which the LLC is otherwise perfectly capable of carrying on its business to achieve "any lawful purpose" but fails to do so in a manner that complies with the terms that its governing documents set forth to govern the relations of the members and the internal affairs of the company. Section 11.314 grants the court jurisdiction to order winding up in those situations. One Texas court has rejected a narrow reading of the language,[238] and as noted below, most courts in other jurisdictions do as well.

3. Dealing With Oppression

The reasonable practicability test has been used to deal with oppressive conduct. The definitions of oppressive conduct, as developed in Texas, contemplated two situations: one in which the owner's reasonable expectations were substantially defeated, and the other in which the conduct of the majority owner was "burdensome; harsh and wrongful" and departed from the standards of fair dealing on which every business owner relies.[239] The definitions are overlapping in that some level of fair dealing is obviously a reasonable expectation of the minority owner. Courts further developed the notion of reasonable expectations to include "specific" expectations and "general" expectations.[240] Specific expectations are basically conditions or elements that were agreed to expressly or impliedly, such as an agreement to participate in management or an agreement for continued employment.[241] General expectations are expectations that every owner has based on the nature of ownership, such as sharing proportionately in the profits of the entity.[242]

Without utilizing the language of the shareholder oppression doctrine, courts have found that when controlling owners have

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236. BUS. ORGS. § 3.005(a)(3) (Westlaw).

237. *Id.* § 101.052(a).

238. *See* Dunnagan v. Watson, 204 S.W.3d 30, 43–44 (Tex. App. 2nd 2006).

239. Davis v. Sheerin, 754 S.W.2d 375, 382 (Tex. App. 1st 1988) (quoting Baker v. Commercial Body Builders, Inc., 507 P.2d 387, 393 (1973)).

240. Boehringer v. Konkel, 404 S.W.3d 18, 26 (Tex. App. 1st 2013) (citing Ritchie v. Rupe, 339 S.W.3d 275, 209–292 (Tex. App. 5th 2011)).

241. *Id.*

242. *Id.*

defeated the reasonable expectations of the shareholders or have acted so badly that the business is no longer carried on in a reasonable way, it becomes "not reasonably practicable" to carry on a company's business in conformity with its governing documents.[243]

a. Reasonable Expectations Expressed or Implied in Governing Documents

Courts applying language similar to section 11.314(3) hold that the "reasonably practicable" analysis must begin with the governing documents and that the dissolution issue "is initially a contract-based analysis."[244] As noted above, the governing documents of an LLC consist of its certificate of formation and company agreement. In order to determine whether an LLC is carrying on its business in conformity with its company agreement, we must first determine what are the terms of the company agreement.

The definition of "company agreement" in the TBOC is quite expansive: "'Company agreement' means any agreement, written or oral, of the members concerning the affairs or the conduct of the business of a limited liability company."[245] There may be more than one company agreement. An LLC might have one document entitled "company agreement," but other written or oral agreements among the members that address "the relations among members, managers, and officers of the company, assignees of membership interests in the company, and the company itself; and other internal affairs of the company" would also fit within the definition and constitute part of the company agreement.[246] In *Boehringer*, the appellate court based its holding of shareholder oppression on the defendant's failure to comply with the oral agreement between the two owners at their first organizational meeting that their salaries would remain the same.[247] In shareholder oppression language, that agreement was a specific reasonable expectation.[248] Under section 11.314(3), it would be

243. *See generally Davis*, 754 S.W.2d at 382; *Boehringer*, 404 S.W.3d at 26.

244. *In re* 1545 Ocean Ave., LLC, 72 A.D.3d 121, 128 (N.Y. App. Div. 2010).

245. TEX. BUS. ORGS. CODE ANN. § 101.001(1) (West, Westlaw through 2017 Reg. Legis. Sess.).

246. *Id.* § 101.052(a); *see In re 1545 Ocean Ave*, 72 A.D.3d at 129 ("Where an operating agreement, such as that of 1545 LLC, does not address certain topics, a limited liability company is bound by the default requirements set forth in the LLCL.").

247. *See Boehringer*, 404 S.W.3d at 29.

248. Argo Data Res. Corp. v. Shagrithaya, 380 S.W.3d 249, 265 (Tex. App. 5th 2012) ("Specific expectations require proof of specific facts giving rise to the expectation in a particular case and a showing that the expectation was reasonable under the circumstances of the case as well as central to the minority shareholder's decision to join the venture.

part of the company agreement, and the defendant's failure to comply would constitute carrying on the entity's business not in conformity with its governing documents.

Terms of the company agreement may also be implied-in-fact from the parties' acts, conduct, and course of dealings.[249] For example, two persons may form an LLC with the unstated but mutual intent to receive their proportionate shares in all profits of the company. If both work in the company without salary but are compensated over the years by the consistent practice of distributing available cash, then a jury might very well find that the unstated agreement to distribute available cash to the owners is an implied-in-fact agreement, based on the circumstances, the parties' conduct, and the course of dealings.[250] Such an implied-in-fact agreement, governing the internal affairs of the company, would be part of the company agreement. Professor Moll has written that specific expectations are often implied-in-fact contracts and may be enforced as such, independent of the shareholder oppression doctrine.[251] Under the shareholder oppression doctrine, the sudden refusal of the majority member to distribute available cash after a falling out between the members might constitute oppressive conduct, as it did under similar facts in *Kohannim v. Katoli*.[252] Under section 11.314, it might constitute carrying on the business not in conformity with the governing documents.[253]

Even in the absence of an express or implied agreement, the law often implies a contract term where it is "so clearly within the contemplation of the parties that they deemed it unnecessary to

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Examples of possible specific reasonable expectations are employment in the corporation or a say in management.").

249. Haws & Garrett Gen. Contractors, Inc. v. Gorbett Bros. Welding Co., 480 S.W.2d 607, 609 (Tex. 1972) (stating that an implied contract arises from the parties' acts and conduct); *see also* BoRain Capital, LLC v. Hashmi, 533 S.W.3d 32, 36 (Tex. App. 4th 2017) ("A contract implied-in-fact arises from the acts and conduct of the parties. In the case of an implied contract, mutual assent is inferred from the circumstances; a 'meeting of the minds' is inferred from and evidenced by the parties' conduct and course of dealing.").

250. Lindsey Constr., Inc. v. AutoNation Fin. Servs., LLC, 541 S.W.3d 355, 363 (Tex. App. 14th 2017) ("In cases involving implied contracts, mutual intent is inferred from the circumstances. In determining whether mutual assent is present, courts consider the communications between the parties, the parties' conduct, any course of dealing between the parties, and the surrounding circumstances.").

251. *E.g.*, Douglas K. Moll, *Reasonable Expectations v. Implied-In-Fact Contracts: Is the Shareholder Oppression Doctrine Needed?*, 42 B.C.L. REV. 989 (2001).

252. 440 S.W.3d 798 (Tex. App. 8th 2013), *disapproved of by* Ritchie v. Rupe, 443 S.W.3d 856, 870–71 (Tex. 2014).

253. TEX. BUS. ORGS. CODE ANN. § 11.314 (West, Westlaw through 2017 Reg. Legis. Sess.).

express it."[254] Terms may be implied "where necessary to give effect to the actual intent of the parties" or "when deemed fundamental to the purpose of the contract."[255] Courts "[i]mply certain duties and obligations in order to effect the purposes of the parties in the contracts made."[256] For example, every contract has an implied duty to cooperate in its performance,[257] and "[a]ccompanying every contract is a common-law duty to perform with care, skill, reasonable expedience and faithfulness the thing agreed to be done."[258] Such terms and duties that are implied by law would also constitute a part of the company agreement.

Texas shareholder oppression doctrine had a richly developed jurisprudence dealing with so-called general expectations, which are those expectations that every business owner is presumed to possess merely by virtue of being an owner[259]—such as the expectation to know what is going on in one's business, the expectation to vote, and the expectation to share proportionately in the earnings of the company.[260] LLCs are necessarily creatures founded on contract. The parties entering into those contracts undoubtedly have certain, often unstated, assumptions. A person who invests his capital and labor into an entity expects to participate in the return. One who agrees to own 40% of a business necessarily expects that he will have 40% of the vote and 40% of

254. HECI Expl. Co. v. Neel, 982 S.W.2d 881, 888 (Tex. 1998) (quoting Danciger Oil & Ref. Co. v. Powell, 154 S.W.2d 632, 635 (Tex. 1941)); *see* Douglas v. First Nat'l Bank of Hughes Springs, 529 S.W.3d 98, 100–02 (Tex. App. 6th 2017); *see, e.g.*, Fischer v. CTMI, L.L.C., 479 S.W.3d 231, 239 (Tex. 2016) ("For example, courts often imply a term setting a reasonable 'time of payment' or a reasonable time during which the contract will remain effective.").

255. *In re* XTO Energy Inc., 471 S.W.3d 126, 135 (Tex. App. 5th 2015).

256. Universal Health Servs., Inc. v. Renaissance Women's Group, P.A., 121 S.W.3d 742, 747–48 (Tex. 2003).

257. Lemon v. Hagood, 545 S.W.3d 105, 126 (Tex. App. 8th 2017) ("[A] contracting party has an implied duty to cooperate in every contract in which cooperation is necessary for performance of the contract."); Case Corp. v. Hi-Class Bus. Sys. of Am., Inc., 184 S.W.3d 760, 770 (Tex. App. 5th 2005) ("A duty to cooperate is implied in every contract in which cooperation is necessary for performance of the contract. If applicable, this implied duty requires that a party to a contract may not hinder, prevent, or interfere with another party's ability to perform its duties under the contract."); *see, e.g.*, Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding, 289 S.W.3d 844, 850 (Tex. 2009) ("When the nature of the work the employee is hired to perform requires confidential information to be provided for the work to be performed by the employee, the employer impliedly promises confidential information will be provided.").

258. Montgomery Ward & Co. v. Scharrenbeck, 204 S.W.2d 508, 510 (Tex. 1947).

259. Argo Data Res. Corp. v. Shagrithaya, 380 S.W.3d 249, 265 (Tex. App. 5th 2012) ("In contrast, general reasonable expectations are expectations that arise from the mere status of being a shareholder. These expectations belong to all shareholders and, absent evidence to the contrary, are both reasonable and central to the decision to invest in the corporation.").

260. Boehringer v. Konkel, 404 S.W.3d 18, 26 (Tex. App. 1st 2013) *disapproved of on other grounds by* Ritchie v. Rupe, 443 S.W.3d 856 (Tex. 2014).

the profits. One who enters into a company agreement that specifies what his vote is and how he exercises it, necessarily assumes that he will be given the opportunity to vote. These assumptions are universal and flow logically and necessarily from the nature of ownership in a company. They also necessarily imply a duty on all the other owners not to interfere with these expectations. The *Boehringer* court held that the cutting off of dividends coupled with increased compensation to the majority owner in the nature of an informal dividend defeated the plaintiff's general reasonable expectation of proportionate sharing in profits.[261] In a case brought under section 11.314(3), the court might hold that the defendant's conduct failed to comply with implied terms of the company agreement and was thus, the carrying on of the entity's business not in conformity with its governing documents.

Finally, duties imposed on managers and managing members by the law are also implied terms of the company agreement. Texas law has long held that business organizations statutes are applied contractually to companies and owners—that is, the TBOC is part of the company agreement.[262] By its terms, the LLC chapter of the TBOC provides that the statute "governs the internal affairs of the company" whenever not inconsistent with the company agreement.[263] Courts have applied the reasonable practicability test to companies without a formal company agreement based on whether it was reasonably practicable to carry on the entity's business in conformity with the LLC statute.[264]

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261. *Id.* at 33.

262. *See* Shanken v. Lee Wolfman, Inc., 370 S.W.2d 197, 200 (Tex. Civ. App. 1963) ("The law is well settled that both the charter of a corporation and the Business Corporation Act become a part of the contract between the shareholders."); Ainsworth v. Southwest Drug Corp., 95 F.2d 172, 173 (5th Cir. 1938) ("[T]he charter and by-laws of a corporation constitute a contract between the company and its stockholders, into which the statutes of the state of its incorporation enter and are controlling.").

263. TEX. BUS. ORGS. CODE ANN. § 101.052(b) (West, Westlaw through 2017 Reg. Legis. Sess.) ("To the extent that the company agreement of a limited liability company does not otherwise provide, this title and the provisions of Title 1 applicable to a limited liability company govern the internal affairs of the company.").

264. *See, e.g.*, Spires v. Casterline, 778 N.Y.S.2d 259, 266 (N.Y. Sup. Ct. 2004) ("When there is no written Operating Agreement, these statutory default provisions become the terms, conditions, and requirements for the conduct of the members for the operation of the limited liability company. On an application for judicial dissolution, when there is no formal operating agreement of the entity, or any such agreement does not address specific issues, the Court must consider whether it is 'not reasonably practicable' to carry on the business in conformity with the terms of a limited operating agreement or with the terms of the statutorily established operating agreement.").

Common law duties, such as the fiduciary duties of managers and members exercising management over an LLC,[265] would be implied into the terms of the company agreement. The general rule is that the law existing at the time a contract is signed is an implied term of that contract.[266] One Texas court has held that claims against LLC managers for breach of fiduciary duties are disputes "arising out of or relating to" the company agreement, and thus would be subject to an arbitration clause in that agreement.[267]

b. Oppressive Conduct

A court ought to find that, "it is not reasonably practicable to carry on the entity's business in conformity with its governing documents" if controlling members systematically and continually defeat important expectations that are expressly or impliedly part of the company agreement.[268] Courts in other jurisdictions have held that the refusal by controlling members and managers of LLCs to govern according to the terms of the company agreement may constitute a basis for dissolution. Such a claim was made under the Georgia LLC Act[269] in *Simmons Family Properties, LLLP v. Shelton*.[270] In that case, the LLC's sole manager never called an annual meeting, refused requests by the other members to do so, and refused to attend special meetings called by the other members so as to prevent a quorum.[271] In response to the members' request for a judicial dissolution, the manager argued

265. *See* Bigham v. Se. Tex. Envtl., LLC, 458 S.W.3d 650, 662 (Tex. App. 14th 2015) (holding an LLC member owed fiduciary duties); Pinnacle Data Servs., Inc. v. Gillen, 104 S.W.3d 188, 198 (Tex. App. 6th 2003) *disapproved of on other grounds by* Ritchie v. Rupe, 443 S.W.3d 856 (Tex. 2014) (holding that managers in an LLC owe fiduciary duties analogous to directors in a corporation).

266. City of Houston v. Williams, 353 S.W.3d 128, 141 (Tex. 2011) ("Further, it is 'settled that the laws which subsist at the time and place of the making of a contract . . . form a part of it, as if they were expressly referred to or incorporated in its terms.'" (quoting Von Hoffman v. City of Quincy, 71 U.S. 535, 550 (1867)); Comcast Cable of Plano, Inc. v. City of Plano, 315 S.W.3d 673, 684 (Tex. App. 5th 2010) ("Every contract incorporates the laws that exist at the time and place of its making, regardless of whether that incorporation is express."); McCreary v. Bay Area Bank & Trust, 68 S.W.3d 727, 733 (Tex. App. 14th 2001) ("However, it is well settled that the laws which are in existence at the time of the making of the contract enter into and become a part of such contract as if expressly referred to or incorporated therein.").

267. Seven Hills Commercial, LLC v. Mirabal Custom Homes, Inc., 442 S.W.3d 706, 719 (Tex. App. 5th 2014).

268. BUS. ORGS. § 11.314 (Westlaw).

269. GA. CODE ANN. § 14-11-603(a) (West, Westlaw through the 2018 Reg. Legis. Sess.) ("On application by or for a member, the court may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business in conformity with the articles of organization or a written operating agreement.").

270. 705 S.E.2d 258, 259 (Ga. Ct. App. 2010).

271. *Id.*

that "dissolution is not allowed where, as here, the company was carrying on its business functions in accordance with the operating agreement, but there was a technical violation of the agreement regarding meetings, and two of the members simply wanted to rewrite the agreement."[272] The trial court disagreed and granted the dissolution, and the Georgia Court of Appeals affirmed.[273] The court held that failure to allow meetings was "'more than a formality,' as such meetings are the primary venue in the operating agreement for non-managing members to have their voices heard" and that such conduct "impeded the members' ability to protect their investments by contributing to the direction of the company"; therefore, "the trial court did not err in finding that it was not reasonably practicable for [the LLC] to carry on business in conformity with the operating agreement, and did not err in granting the petition to dissolve the limited liability company."[274]

Courts have also found it not reasonably practicable to carry on the business of a company in conformity with its governing documents as a result of a wide range of oppressive conduct by controlling owners. In *Ramos v. Perez*, a dispute between LLC members was arbitrated, and the arbitrator found that an LLC member breached fiduciary duties to the LLC and to one of the other members by transferring company property to other entities.[275] The arbitrator awarded no damages but ordered equitable relief of "zeroing out capital accounts and winding up of the company."[276] One of the parties attacked the award under § 10(a)(4) of the Federal Arbitration Act,[277] claiming that the arbitrator had "exceeded [his] powers or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made," on the grounds that the winding up order based on a finding of breach of fiduciary duties was not available under Texas law.[278] The trial court granted the motion

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272. *Id.* at 260.

273. *Id.* at 259.

274. *Id.* at 261. *But see In re* Seneca Invs. LLC, 970 A.2d 259, 263–64 (Del. Ch. 2008) ("Even assuming that Seneca is in violation of some provisions of its operating agreement, such violations are not grounds for this Court to order dissolution of an LLC. The role of this Court in ordering dissolution under § 18-802 is limited, and the Court of Chancery will not attempt to police violations of operating agreements by dissolving LLCs. This Court will also not attempt to divine some other business purpose by interpreting provisions of the governing documents other than the purpose clause.").

275. Ramos v. Perez, No. 13-10-00350-CV, 2011 WL 3557311, at *1 (Tex. App. 13th Aug. 11, 2011).

276. *Id.* at *4.

277. 9 U.S.C.A. § 10(a)(4) (Westlaw through P.L. 115-223).

278. *Ramos*, 2011 WL 3557311, at *4.

and vacated the award.[279] The Corpus Christi Court of Appeals reversed and held that the law permitted equitable relief, including dissolution, to be awarded for breach of fiduciary duties, citing section 11.314.[280] In *Suntech Processing Systems, L.L.C. v. Sun Communications, Inc.*, one member of an LLC sued the controlling member claiming that the controlling member was breaching fiduciary duties by causing the company to transfer over $9 million for his benefit.[281] The trial court granted a temporary injunction prohibiting the transfer but also ordered the liquidation of the LLC and appointed a receiver.[282] The Dallas Court of Appeals did not question the basis of the order, and it expressly overruled the appellant's argument that there was an adequate remedy at law,[283] however, the court reversed the receiver and liquidation on the grounds that this was an ultimate relief and not available through a temporary injunction.[284]

In *Gagne v. Gagne*, the Colorado Court of Appeals held that misconduct is "one factor that a court may consider in determining whether a business's continued operation is reasonably practicable."[285] In *In re Cat Island Club*, the Louisiana Court of Appeals concluded that it was not reasonably practicable to carry on the business of an LLC where certain members believed another member was engaged in self-dealing, and the members had "clearly reached an inability to work toward any goals or reasons for continued association with each another."[286] In *McGovern v. General Holding, Inc.*,[287] the Delaware Chancery Court dissolved a limited partnership, based on language nearly identical to section 11.314(3).[288] The court found it was unlikely that the general partner and 90% owner, who committed a variety of fiduciary and contractual breaches, would "mend his ways and begin to act as a trustworthy general partner," but it was also unlikely that the partnership would be viable under substitute management given the general partner's large ownership stake

279. *Id.* at *3.

280. *Id.* at *4.

281. Suntech Processing Sys., L.L.C. v. Sun Commc'ns, Inc., No. 05-98-00799-CV, 1998 WL 767672, at *2 (Tex. App. 5th Nov. 5, 1998).

282. *Id.* at *1.

283. *Id.* at *4.

284. *Id.* at *5–6.

285. Gagne v. Gagne, 338 P.3d 1152, 1161 (Colo. App. 2014).

286. *In re* Cat Island Club, L.L.C., 94 So.3d 75, 79 (La. Ca. App. 2012).

287. No. Civ..A 1296-N., 2006 WL 1468850 (Del. Ch. May 18, 2006).

288. *Id.* at *24. DEL CODE ANN. tit. 6, § 17-802 (West, Westlaw through 81 Laws 2018) ("On application by or for a partner the Court of Chancery may decree dissolution of a limited partnership whenever it is not reasonably practicable to carry on the business in conformity with the partnership agreement.").

and the importance of his knowledge and skills to the business.[289] In *In re Rueth Development Co.*, the Indiana Court of Appeals rejected a claim that the court had no jurisdiction to order a dissolution under a statute nearly identical to section 11.314(3),[290] where the death of one of the parties had resolved the deadlock.[291] The court held that breaches of fiduciary duties had been alleged as an alternative ground for dissolution and that the trial court retained jurisdiction over the dissolution claim because "a breach of fiduciary duty may also make it impracticable to carry on the business of the partnership."[292] In *Connors v. Howe Elegant, LLC*, a Connecticut court ordered the dissolution of an LLC under the reasonable practicability test where the two members were unable to come to terms about the business's future or the terms of dissolution, and one member then locked the other out of the business's premises, subsequently closed the business's bank account, transferred those funds into an account that the other member could not access, and personally withdrew about $4,500 in operating cash.[293]

Equity jurisprudence in Texas has long held that egregious misconduct by those in control of a company may be grounds for dissolution where there is no other way to protect minority interests.[294] The Texas Supreme Court in *Patton v. Nicholas* held:

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289. *McGovern*, 2006 WL 1468850, at *24. A subsequent discussion of this case by another Delaware court noted: "In that case, the partnership agreement contained a relatively narrow purpose clause, but the concerns animating the holding would seem applicable to an entity with a broader purpose." *In re* Arrow Inv. Advisors, LLC, C.A. No. 4091-VCS, 2009 WL 1101682, at *3 (Del. Ch. Apr. 23, 2009).

290. IND. CODE ANN. § 23-16-9-2 (West, Westlaw through 2018 Reg. Legis. Sess.) ("On application by or for a partner, the circuit or superior court of the county in which the office of the limited partnership referred to in IC 23-.05-4 is located may decree dissolution of a limited partnership whenever it is not reasonably practicable to carry on the business in conformity with the partnership agreement.").

291. *In re* Rueth Dev. Co., 976 N.E.2d 42, 54–55 (Ind. Ct. App. 2012).

292. *Id.* at 55.

293. Connors v. Howe Elegant, LLC, No. 4003783, 2009 WL 242324, at *1 (Conn. Super. Ct. Jan. 8, 2009), *modified on reargument*, No. 4003783, 2009 WL 651735 (Conn. Super. Ct. Feb. 11, 2009).

294. *See, e.g.*, Hammond v. Hammond, 216 S.W.2d 630, 633 (Tex. App. 2nd 1948) ("Our conclusion, after considering many of the authorities referred to, is that a court of equity may properly take jurisdiction to wind up the affairs of a corporation and sell and distribute its assets at the suit of a minority stockholder on the ground of dissensions among the stockholders, but that it is only an extremely aggravated condition of affairs that will warrant such drastic action, and that the court will follow such a procedure only when it reasonably appears that the dissensions are of such nature as to imperil the business of the corporation to a serious extent and that there is no reasonable likelihood of protecting the rights of the minority stockholder by some method short of winding up the affairs of the corporation."); *see also* Leck v. Pugh, 676 S.W.2d 180, 181 (Tex. App. 10th 1984). The court explained there was no abuse of discretion in ordering liquidation of a corporation where "Leck and plaintiff Pugh are 50% owners each in the corporation and have been since 1972;

"Our conclusion is that Texas courts, under their general equity powers, may, in the more extreme cases of the general type of the instant one [malicious suppression of dividends], decree liquidation."[295] That opinion noted the availability of dissolution under the court's equitable powers "where control of an evidently solvent corporation by the dominant stockholder-officer operated to deny dividends to the principal minority stockholder over a period of years as well as to cloak considerable piracy of corporate assets by the former" and where it would likely be futile to try to protect the minority shareholder "against the probable future misconduct of an evidently wrong-minded person in control of a corporation."[296] The *Ritchie v. Rupe* opinion extensively considered the *Patton* decision.[297] *Ritchie* did not overrule or limit *Patton*,[298] but rather held:

> Our recognition in *Patton* that the statutory action for receivership did not displace Texas courts' historical power to grant receivership as an equitable remedy under a common-law cause of action does not support the court's construction of former article 7.05 [§ 11.404] to provide a different statutory remedy, a buyout, without regard to any common-law cause of action.[299]

Courts in other jurisdictions have been particularly willing to grant dissolution where the controlling member was acting oppressively by operating the business for his sole benefit. *Haley v. Talcott* found that, although the LLC was "technically functioning" and financially stable, meaning that it received rent checks and paid a mortgage, it should be dissolved because the company's activity was "purely a residual, inertial status quo that just happens to exclusively benefit one of the 50% members."[300] The South Dakota Supreme Court held: "Leaving two sisters, half the owners, with all the power in the operation of the company cannot be a reasonable and practicable operation of a business."[301]

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have been in continuous litigation with each other since 1973; and receivership was decreed in 1979. The parties are irrevocably at odds with no reasonable chance for any change." *Id.*

295. Patton v. Nicholas, 279 S.W.2d 848, 856–57 (Tex. 1955).

296. *Id.* at 855.

297. Ritchie v. Rupe, 443 S.W.3d 856, 876 (Tex. 2014); *see Patton*, 443 S.W.3d at 876, 883–85.

298. *See generally* Fryar, *Part 1*, *supra* note 6, at 104–115 (criticizing *Ritchie's* reading of *Patton* as flawed and disingenuous).

299. *Ritchie*, 443 S.W.3d at 876.

300. Haley v. Talcott, 864 A.2d 86, 96 (Del. Ch. 2004); *see also* Fisk Ventures, LLC v. Segal, No. 3017-CC, 2009 WL 73957, at *4 (Del. Ch. Jan. 13, 2009), *aff'd*, Shortridge v. Del. Hospice, 984 A.2d 124 (Del. 2009).

301. Kirksey v. Grohmann, 754 N.W.2d 825, 831 (S.D. 2008).

Some courts have refused to consider breach of fiduciary duties and oppressive conduct as grounds for dissolution under the reasonable practicability standard.[302] One Delaware court cautioned that dissolution will not be granted for claims of breaches of fiduciary duties when "more appropriate and proportional relief is available."[303] Additionally, a dissolution claim must not be used to skirt "policy-based rules governing such claims," such as the demand requirement for derivative claims.[304] However, that same court noted that there would be exceptions where the conduct was egregious and there was no indication that the wrong-doer would "mend his ways."[305]

The bottom line, according to the South Dakota Supreme Court, is: "As long as the company remains in control of, and favorable only to, half its members, it cannot be said to be reasonably practicable for it to continue in accord with its operating agreement."[306]

c. Dissension

Even in the absence of outright refusal to comply with the company agreement, dissolution may also be available where dissension among the members is so severe that the company is dysfunctional. Texas courts construe contracts "from a utilitarian standpoint, bearing in mind the particular business activity sought to be served."[307] The business purpose to be served in most LLC company agreements is running of a business with the participation and for the benefit of all the members. Most company agreements and the provisions of the TBOC that are implied into those agreements contemplate meetings,[308] votes,[309] and input by members and managers. Dissension among the members, and particularly oppressive conduct by the controlling member that

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302. *See, e.g.*, Widewaters Herkimer Co. v. Aiello, 817 N.Y.S.2d 790, 792 (N.Y. App. Div. 2006) ("In alleging that the majority members breached their fiduciary duty to defendants and engaged in unlawful or oppressive conduct toward them, defendants 'did not plead the requisite grounds for dissolution of a limited liability company.'").

303. *In re* Arrow Inv. Advisors, LLC, C.A. No. 4091-VCS, 2009 WL 1101682, at *1 (Del. Ch. Apr. 23, 2009).

304. *Id.* at *4.

305. *Id.* at *3 n.20. *But see* Gutchess 1998 Irrevocable Trust v. Gutchess Cos., C.A. No. 4916-VCN, 2010 WL 718628, at *2 (Del. Ch. Feb. 22, 2010) ("As the Court in *Arrow Investment* made clear, alleged breaches of fiduciary duty, by themselves, are insufficient to withstand a motion to dismiss a petition for dissolution.").

306. *Kirksey*, 754 N.W.2d at 831.

307. Apache Deepwater, LLC v. McDaniel Partners, Ltd., 485 S.W.3d 900, 906–07 (Tex. 2016); Akhtar v. Leawood Hoa, Inc., 508 S.W.3d 758, 763 (Tex. App. 1st 2016).

308. *E.g.*, TEX. BUS. ORG. CODE ANN. §101.352 (West, Westlaw through 2017 Reg. Legis. Sess.).

309. *E.g.*, *id.* § 101.357.

shuts out participation by certain members, may certainly render it not reasonably practicable to carry on the business of the LLC in conformity to its governing documents, when those documents are construed from a utilitarian standpoint.

In *Dunnagan v. Watson*,[310] the Fort Worth Court of Appeals affirmed the dissolution of a limited partnership under the predecessor to Section 11.341 based on evidence that the "ends" partnership had been

> frustrated not only by the failure of the limited partnership to obtain a racing license and operate a horse racing track, which was the "purpose" of the limited partnership, but by the seemingly endless disagreements and discontent between Dunnagan and Watson. Accordingly, viewing the evidence favorable to the jury's finding and disregarding the evidence and inferences contrary thereto, we hold that the evidence is legally sufficient to support the jury's finding that the actions of Dunnagan rendered it not practicable for the limited partnership to continue.[311]

In *Kirksey v. Grohmann*, four sisters each contributed their one-fourth interest in the family ranch and formed an LLC to hold title to the land and maintain the ranching operations.[312] Subsequently, the family relationship went sour with the sisters deadlocked two against two at the member level, but with two of the sisters in management control of the company.[313] The South Dakota Supreme Court held that "it is not reasonably practicable to carry on the LLC's business in conformity with its articles of organization and operating agreement" because of the dissension among the members:

> Here, we have two members of an LLC that hold all the power, with the other two having no power to influence the company's direction . . . . The members cannot communicate regarding the LLC except through legal counsel. The company remains static, serving the interests of only half its owners. They neither trust nor cooperate with each other. The sisters formed their company contemplating equal ownership and management, yet only an impenetrable deadlock prevails.[314]

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310. 204 S.W.3d 30 (Tex. App. 2nd 2006).

311. *Id.* at 44.

312. Kirksey v. Grohmann, 754 N.W.2d 825, 827 (S.D. 2008).

313. *Id.* at 831.

314. *Id.*

In *Taki v. Hami*, the two parties

> had not spoken to each other since 1995, except through their attorneys, and had filed three lawsuits against each other. Because of their inability to operate Showbiz together, and pursuant to the settlement of one of the lawsuits, Hami sold all of his interest in the corporation to Taki. Thereafter, Hami, on behalf of the partnership, attempted to evict Showbiz and Stallion from the partnership's premises without any notice or consultation with Taki and despite the fact that both tenants were paying the fair market rental value for the property. In addition, Taki was fearful of violence because Hami was carrying a firearm when he was planning on meeting with Taki.[315]

The Michigan Court of Appeals held that it was not reasonably practicable to carry on the business of the partnership because the dissension between the partners precluded their ability "to carry out the business of the partnership logically and in a reasonable, feasible manner."[316] In *Gagne v. Gagne*, the Colorado Court of Appeals upheld dissolution where

> the summary judgment record is replete with evidence of extreme dysfunction between the parties. This evidence includes allegations of physical altercations; assertions that Paula fears Richard and his wife; and statements by Paula that her relationship with Richard and his family "ha[d] deteriorated to zero" and that "[e]veryone in my life is unanimous that the partnerships need to end for both our sakes."[317]

Where substantial dissension exists, courts reject the argument that it is reasonably practicable to carry on the business in conformity with its governing documents merely because one party is in control of management and technically can continue operations. In *Dunnagan v. Watson*, the Fort Worth Court of Appeals rejected the defendant's argument that the limited partnership should not be dissolved because the plaintiffs had been voted out of management and the defendant had acquired majority ownership in the limited partnership and its corporate general partner,[318] holding that such a result would render the "reasonably practicable" language of the statute "virtually useless."[319] In *In re Cat Island Club*, the Louisiana Court of

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315. Taki v. Hami, No. 219307, 2001 WL 672399, at *3 (Mich. Ct. App. 2001).

316. *Id.*

317. Gagne v. Gagne, 338 P.3d 1152, 1162 (Colo. App. 2014).

318. Dunnagan v. Watson, 204 S.W.2d 30, 44 (Tex. App. 2nd 2006).

319. *Id.*

Appeals disagreed with the defendants' argument that "it is still 'reasonably practicable' to carry on the business of the LLC."[320] The court stated:

> [N]umerous accusations have arisen surrounding the operation of the LLC and the ownership interest of the members. There also appear to be competing interests regarding the use of the land, the only asset of the company, and the reason for which the LLC was created. In alleging a fraudulent Operating Agreement, Pentecost and Gaspard clearly believe there is self-dealing on the part of Ty–Bar. Ty–Bar and Davis want dissolution and liquidation of the land while Pentecost and Gaspard do not. The members have clearly reached an inability to work toward any goals or reasons for continued association with each other.[321]

In *Gagne v. Gagne*, the Colorado Court of Appeals rejected the defendant's argument that her 51% voting interest and position as CEO of the LLC made it reasonably practicable to carry on the business "in a reasonable, sensible, and feasible manner."[322] The court reasoned that "[w]ith respect to Paula's position as Chief Executive Manager and her fifty-one percent voting interest, . . . it is not clear to us that the LLC Agreements give her the unilateral right to control all management of the properties, regardless of Richard's views and cooperation."[323]

In *Haley v. Talcott*, the "parties have not interacted since their falling out in October of 2003. Clearly, Talcott understands that the end of Haley's managerial role from the Redfin Grill profoundly altered their relationship as co-members of the LLC. After all, it has left Haley on the outside, looking in, with no power."[324] The Delaware Chancery Court rejected the defendant's position that

> the LLC can and does continue to function for its intended purpose and in conformity with the agreement, receiving payments from the Redfin Grill and writing checks to meet its obligations under the mortgage on Talcott's authority. But that reality does not mean that the LLC is operating in accordance with the LLC Agreement. Although the LLC is technically functioning at this point, this operation is purely a residual, inertial status quo that just happens to exclusively benefit one of the 50% members.[325]

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320. *In re* Cat Island Club, L.L.C., 94 So.3d 75, 79 (La. Ct. App. 2012).
321. *Id.*
322. Gagne v. Gagne, 338 P.3d 1152, 1162 (Colo. App. 2014).
323. *Id.*
324. Haley v. Talcott, 864 A.2d 86, 96 (Del. Ch. 2004).
325. *Id.*

The court held that it was not reasonably practicable to carry on the business of the LLC in conformity with its governing documents because of the "strident disagreement between the parties regarding the appropriate deployment of the asset of the LLC, and open hostility as evidenced by the related suit in this matter" and because of the clear "inability of the parties to function together."[326] The fact that the dissension among the parties has effectively placed one party in operational control does not prevent dissolution if the other party "never agreed to be a passive investor in the LLC who would be subject to [the controlling party's] unilateral dominion."[327] In *Navarro v. Perron*, the court held that it was not reasonably practicable for a partnership to carry on in conformity to its governing documents under a California statute[328] where "the relationship between the parties has so deteriorated that common ownership is no longer possible," based on "extensive litigation, including mutual restraining orders."[329]

Similarly, contractual mechanisms that might resolve an impasse do not necessarily make it reasonably practicable to carry on the business in conformity with the governing documents. In *Gagne v. Gagne*, the defendant had the unilateral right to sell all the assets of the LLC and terminate its existence, but the Colorado Court of Appeals held that such a right would not prevent dissolution unless and until it was exercised.[330] In *Haley v. Talcott*, the LLC agreement provided an exit mechanism allowing either party to leave voluntarily; however, the Delaware Chancery Court held that it was inequitable to force the plaintiff to exercise the contractual exit mechanism to avoid dissolution: "[F]orcing Haley to exercise the contractual exit mechanism would not permit the LLC to proceed in a practicable way that accords with the LLC Agreement, but would instead permit Talcott to penalize Haley without express contractual authorization."[331] The inequity was particularly egregious in that case because a voluntary exit would not relieve the plaintiff of his personal guaranty on the mortgage on the LLC's assets.[332]

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326. *Id.*

327. *Id.* at 95.

328. CAL. CORP. CODE § 16801 (West, Westlaw through 2018 Reg. Legis. Sess.) ("A partnership is dissolved, and its business shall be wound up, only upon the occurrence of any of the following events: . . . On application by a partner, a judicial determination that any of the following apply: . . . It is not otherwise reasonably practicable to carry on the partnership business in conformity with the partnership agreement.").

329. Navarro v. Perron, 19 Cal. Rptr. 3d 198, 200–01 (Cal. Ct. App. 2004).

330. Gagne v. Gagne, 338 P.2d 1152, 1162 (Colo. App. 2014).

331. *Haley*, 864 A.2d at 97.

332. *Id.* at 98.

B. *Economic Purpose Test*

Beginning in 2017, Texas LLCs also became subject to the test, which allows dissolution when "the economic purpose of the entity is likely to be unreasonably frustrated."[333] As noted above, courts already find that "it is not reasonably practicable to carry on the entity's business in conformity with its governing documents" when an entity is failing financially.[334] An economic purpose of every for-profit entity is to make money. "Dissolution generally has been deemed appropriate when a company's economic purpose is not being met, or when the company is failing financially."[335]

The extension of the economic purpose test to LLCs must have been meant to address circumstances beyond those to which the reasonably practical test had been applied. The language provides some important clues. First, use of the phrase "unreasonably frustrated" rather than the "not reasonably practicable to carry on" used in the other two tests must be significant. An economic purpose might be frustrated even in situations where it is otherwise reasonably practicable to carry on the business. Second, the subject of the test—economic purpose—is not tied to the purpose stated in the governing documents. It is no stretch to argue that the economic purpose of every venture is to make money for the benefit of its owners. This economic purpose might be unreasonably frustrated in an otherwise profitable entity where the finances are manipulated by the majority owner to the detriment of the minority owner. Third, the economic purpose test uses the term "likely," meaning that the circumstances that might trigger the court's jurisdiction include future or threatened events.

1. Agreed Purpose Frustrated

One recent Texas decision applies the economic purpose test in a partnership dissolution action. In *CBIF Ltd. Partnership v. TGI Friday's Inc.*, the Dallas Court of Appeals affirmed the judicial winding up of a joint venture established to operate TGI Friday's restaurants and café bars at DFW International Airport.[336] The jury found that the court's winding up jurisdiction was triggered by all three tests:

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333. TEX. BUS. ORGS. CODE ANN. § 11.314(1) (West, Westlaw through 2017 Reg. Legis. Sess.).

334. *E.g.*, PC Tower Ctr., Inc. v. Tower Ctr. Dev. Assoc., No. 10788, 1989 WL 63901, at *6 (Del. Ch. June 8, 1989).

335. Venture Sales, LLC v. Perkins, 86 So. 3d 910, 914–15 (Miss. 2012).

336. CBIF Ltd. P'ship v. TGI Friday's Inc., No. 05-15-00157-CV, 2017 WL 1455407, at *1 (Tex. App. 5th Apr. 21, 2017).

> After a lengthy trial, the jury made the following findings: . . . The economic purpose of [the joint venture] had been unreasonably frustrated and likely would be frustrated in the future; CBIF engaged in conduct that made it not reasonably practicable to carry on the business of [the joint venture] in partnership with CBIF; and it was not reasonably practicable for the joint venture to carry on its business in conformity with its governing documents.[337]

However, the court of appeals addressed only the economic purpose test. The principal argument on appeal was that the economic purpose of the venture was never frustrated because "the venture has made profits of over $70 million from 1995 through 2013."[338] The court examined the joint venture agreement, which stated that the purpose was "to construct, outfit and operate for profit" Friday's restaurants and café bars at the airport, and that the joint venture had entered into a lease agreement with the airport to accomplish that purpose.[339] The evidence established that the joint venture had lost the lease in one terminal and was likely to lose the remaining spaces.[340] Without the lease, the joint venture's agreed economic purpose "to construct, outfit and operate for profit," the court held, "has been unreasonably frustrated and will likely be unreasonably frustrated in the future."[341]

2. Reasonable Expectations as Economic Purpose

As discussed above, reasonable expectations, both general and specific, may be part of the company agreement, but they may also constitute the economic purposes of the company. In every case, in order to apply the economic purpose test, the finder of fact must determine the economic purpose or purposes of the LLC. The logical question to ask is: Why did the owners create and operate this company? In almost every case, one of the answers will be "to make money and share it in proportion to ownership." Shareholder oppression jurisprudence recognizes that the "right to proportionate participation in the earnings of the company" is a general expectation, which "arise[s] from the mere status of being a shareholder" and "belong[s] to all shareholders."[342] Substitute the words "economic purpose" for "general reasonable expectation"

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337. *Id.* at *7.
338. *Id.* at *10.
339. *Id.*
340. *Id.* at *11.
341. *Id.*
342. Boehringer v. Konkel, 404 S.W.3d 18, 26 (Tex. App. 1st 2013).

and "LLC member" for "shareholder," and the proposition remains true. Therefore, a member of an LLC who is systematically cut off from participation in the earnings of the company ought to be able to invoke the economic purpose test.

Some courts have expanded the economic purpose test to situations that are quite similar to classic shareholder oppression scenarios. One interesting opinion by the Virginia Supreme Court analyzed the economic purpose test in a partnership context. The Virginia partnership dissolution statute contains an economic purpose test identical to that in the Texas statute.[343] In *Russell Realty Associates v. Russell*, the trial court ordered the dissolution of a partnership based on two alternative grounds, one of which was the economic purpose test.[344] The appellant argued that the economic purpose test was limited to companies that were failing financially and that the partnership in question was profitable. The Virginia Supreme Court rejected that argument, explaining that "[n]either the language of Code § 50–73.117(5) nor the RUPA comment relevant to that section requires that a partnership be a financial failure to sustain a judicial dissolution under the economic purpose prong."[345] The court defined the economic purpose of the partnership based on the partners' expectations of economic success through a business that operated "in an efficient and productive manner to maximize return to the partnership."[346] The court held that the evidence established that the relations of the partners was characterized by distrust, dissension, and disagreement that had frustrated efforts to take advantage of business opportunities in the past, resulted in the incurring of additional costs in employing lawyers to facilitate communication, and interfered with the conducting of business in a timely and efficient manner.[347]

> The relationship also imposed significant additional costs in terms of the time spent resolving issues directly and indirectly affecting the purposes of the Partnership. The relationship between the partners has deteriorated over the years and nothing in the record suggests that it will improve. For these reasons, we conclude that the record

343. VA. CODE ANN. § 50-73.117 (West, Westlaw through 2018 Reg. Legis. Sess.) ("A partnership is dissolved, and its business shall be wound up, only upon the occurrence of any of the following events: . . . . On application by a partner, a judicial determination that . . . [t]he economic purpose of the partnership is likely to be unreasonably frustrated.").

344. Russell Realty Assocs. v. Russell, 724 S.E.2d 690, 693 (Vir. 2012) ("[T]he trial court dissolved RRA based on the first and third statutory bases: the economic purpose test and the business operations test.").

345. *Id.* at 694.

346. *Id.*

347. *Id.* at 694–95.

> supports the circuit court's holding that the economic purpose of the Partnership is likely to be unreasonably frustrated.[348]

In *Wood v. Apodaca*, the court found that a partnership's economic purpose was unreasonably frustrated because certain partners "fail[ed] to fulfill their side of the bargain" by refusing to invest a promised sum of $250,000.[349] In *Kirksey v. Grohmann*, described in the preceding section, the South Dakota Supreme Court held the economic purpose test was an alternative ground for affirming the dissolution order.[350] The court held that the economic purpose of the LLC was unreasonably frustrated where four "sisters formed their company contemplating equal ownership and management," but now "two members of an LLC . . . hold all the power, with the other two having no power to influence the company's direction," and "[t]he company remains static, serving the interests of only half its owners."[351]

C. Owner Conduct Test

Finally, Texas LLCs may be subject to winding up if an "owner has engaged in conduct relating to the entity's business that makes it not reasonably practicable to carry on the business with that owner."[352] This "owner conduct test" occurs on "application by an owner of the partnership or limited liability company" complaining about the conduct of another owner to the effect that it is not reasonably practicable for the two owners to continue in business together.[353] This is a very different inquiry than under the other two tests, which both focus on the company. The owner conduct test focuses on the actions of a particular owner and necessarily includes the specific treatment of other owners. O'Neal and Thompson posit that the owner conduct test "suggests a focus on the majority's conduct toward a minority member."[354] No Texas cases have been decided under the owner conduct test, but Texas shareholder oppression jurisprudence discussing the type of conduct that would justify the buy-out of a minority shareholder certainly seems to fit: "burdensome, harsh, or

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348. *Id.* at 807.

349. Wood v. Apodaca, 375 F. Supp. 2d 942, 948–49 (N.D. Cal. 2005).

350. Kirksey v. Grohmann, 754 N.W.2d 825, 831 (S.D. 2008).

351. *Id.*

352. TEX. BUS. ORGS. CODE § 11.314(2) (West, Westlaw through 2017 Reg. Legis. Sess.).

353. *Id.* § 11.314.

354. F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL & THOMPSON'S CLOSE CORPORATIONS & LLCS: LAW & PRACTICE § 5:23 (July 2018), Westlaw CCORPLLC § 5:23.

wrongful conduct; a lack of probity and fair dealing in the company's affairs to the prejudice of some members; or a visible departure from the standards of fair dealing and a violation of fair play on which each [business owner] is entitled to rely."[355] In fact, the definition of oppressive conduct may well be more narrow than the universe of conduct that would satisfy the owner conduct test.

Five other states have LLC dissolution statutes containing the three tests in essentially identical language to the Texas statute.[356] The official commentaries to the Montana and South Carolina statutes state that the owner conduct test is satisfied by "serious and protracted misconduct by one or more members."[357] In *Gordon v. Kuzara*, a case decided under the Montana statute, the court held that the following conduct would be sufficient to satisfy the owner conduct test: depositing multiple checks into the LLC account, and then writing checks in the identical amounts to the defendant's family corporation; writing a check without authority for $2,000 from the LLC account to defendant's family corporation, causing an overdraft; and charging the LLC for defendant's own time without authority.[358] The court held that dissolution of the LLC was warranted because "[t]he reasonable conclusion was that [the defendant], as a member of the LLC, was being disproportionately enriched . . . all to the detriment of the cattle business of the LLC and to the detriment of the [other members], who held a 50% interest in the enterprise."[359]

While there is little case law interpreting the owner conduct test in the LLC context, a number of states have the same test in their statutes dealing with the remedies of dissolution or dissociation in partnerships.[360] In *Giles v. Giles Land Co.*, the court held that the ownership conduct test was satisfied when one member of a family partnership harbored animosity toward the

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355. Boehringer v. Konkel, 404 S.W.3d 18, 25 (Tex. App. 1st 2013) (citing Willis v. Bydalek, 997 S.W.2d 798, 801 (Tex. App. 1st 1999)), *disapproved of by* Ritchie v. Rupe, 443 S.W.3d 856 (Tex. 2014).

356. OHIO REV. CODE ANN. § 1705.47 (Baldwin, Westlaw through File 105 of the 132nd Assemb. (2017–2018)); S.D. CODIFIED LAWS § 47-34A-801 (Westlaw through 2018 Sess. Laws and S.D. Rule 18-15); MONT. CODE ANN. § 35-8-902 (West, Westlaw through 2017 Reg. Legis. Sess.); HAW. REV. STAT. ANN. § 428-801 (West, Westlaw through 2018 Reg. Legis. Sess.); S.C. CODE ANN. § 33-44-801 (Westlaw through 2018 Act No. 263).

357. S.C. CODE ANN. cmt. § 33-44-801 (West); MONT. CODE ANN. § 35-8-902 (West).

358. Gordon v. Kuzara, 286 P.3d 895, 898–99 (Mont. 2012).

359. *Id.* at 899.

360. *E.g.*, KAN. STAT. ANN. § 56a-601 (West, Westlaw through 2018 Reg. Legis. Sess.) ("A partner is dissociated from a partnership upon the occurrence of any of the following events: . . . on application by the partnership or another partner, the partner's expulsion by judicial determination because . . . the partner engaged in conduct relating to the partnership business which makes it not reasonably practicable to carry on the business in partnership with the partner.").

other partners, refused to communicate with them, and threatened them.[361] "Although [plaintiff] contended that some of these statements were wholly unrelated to the partnership in question, the trial court determined that [plaintiff's] version of the events lacked credibility. Thus, the appropriate remedy under these circumstances is the dissociation of [plaintiff] under K.S.A. 56a–601(e)(3) [the owner conduct test]."[362] Courts have also ordered dissolution of partnerships under the owner conduct test based on a "history of the bad blood,"[363] the failure of a partner to pay rent on property leased from the partnership,[364] harassing other partners, refusing to correspond regarding partnership business, and refusing to participate in necessary meetings and voting procedures such that the majority of the partners were deprived of any benefit from the partnership.[365]

In *Brennan v. Brennan Associates*, the partner in control of the business had "engaged in conduct to maintain such control to the exclusion of everyone else" and engaged in a "pattern of adversarial conduct with [the other partners] that had caused them to mistrust him, including besmirching [one partner's] reputation with a false accusation of fraud."[366] The court held that such conduct justified expulsion of the controlling partner under a Connecticut statute permitting dissociation from a partnership if "the partner engaged in conduct relating to the partnership business which makes it not reasonably practicable to carry on the business in partnership with the partner . . . ."[367] In *Fernandez v. Yates*, the court dissolved a partnership under the owner conduct test where the controlling partner failed to prepare financial statement required by the partnership agreement, refused to meet with the other partners, and paid out $70,000 in partnership funds for his own legal fees without the approval of the other partners.[368]

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361. Giles v. Giles Land Co., 279 P.3d 139, 144 (Kan. Ct. App. 2012).

362. *Id.*

363. Lindsay v. Pac. Topsoils, Inc., Nos. 50556-1-I, 50593-9-I, 2003 WL 22121055, at *18 (Wash. Ct. App. Sept. 15, 2003).

364. Robertson v. Jacobs Cattle Co., 830 N.W.2d 191, 201 (Neb. 2013).

365. Palmer v. Mellen, 412 Ill. Dec. 111, 117 (Ill. App. Ct. 2017).

366. Brennan v. Brennan Assocs., 977 A.2d 107, 119–20 (Conn. 2009).

367. *Id.* at 121–22 (quoting CONN. GEN. STAT. § 34-355(5)(C) (West, Westlaw through 2018 Reg. Legis. Sess.)).

368. Fernandez v. Yates, 145 So. 3d 141, 144–45 (Fla. Dist. Ct. App. 2014).

D. Remedy

Unlike other states in which dissolution is mandatory and the only remedy,[369] the Texas statute is unique. Section 11.314 provides that, if the court determines one of the three tests is satisfied, the district court "has *jurisdiction* to order the winding up and termination of the domestic partnership or limited liability company."[370] A court with jurisdiction over an LLC presumably retains the discretion to order winding up and termination or something else. In fact, section 11.054 makes clear that a district court with jurisdiction to order the winding up of an LLC, in fact, has extremely broad powers to act:

> Subject to the other provisions of this code, on application of a domestic entity or an owner or member of a domestic entity, a court may:
>
> (1) supervise the winding up of the domestic entity;
>
> (2) appoint a person to carry out the winding up of the domestic entity; and
>
> (3) make any other order, direction, or inquiry that the circumstances may require.[371]

1. Winding Up

The remedy mentioned in section 11.314 is an order requiring "the winding up and termination" of the limited liability company.[372] The court obviously may opt to do so. The TBOC provides the court with broad power in a judicially-ordered winding up and allows the court to directly supervise the winding up.[373] Such court supervision would presumably include orders requiring an accounting audit, sale of assets, payment of creditors, and distribution to owners. Alternatively, section 11.054(2) permits the court to "appoint a person to carry out the winding up."[374] The case law makes clear that the person described in this

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369. *E.g.*, S.D. CODIFIED LAWS § 47-34A-801(a) ("A limited liability company is dissolved, and its business must be wound up, upon the occurrence of any of the following events . . . ."); *see also* Pankratz Farms, Inc. v. Pankratz, 95 P.3d 671, 681 (Mont. 2004) (holding the district court erred in ordering a buy-out because the Montana partnership dissolution statute, section 35-10-624, mandated dissolution).

370. TEX. BUS. ORGS. CODE § 11.314 (West, Westlaw through 2017 Reg. Legis. Sess.) (emphasis added).

371. *Id.* § 11.05.

372. *Id.* § 11.314.

373. *Id.* § 11.054(1).

374. *Id.*; *see also id.* § 101.551(2) (providing for winding up to be carried out by "a person appointed by the court to carry out the winding up of the company under Section[s] 11.054, 11.405, 11.409, or 11.410.").

section is not a receiver.[375] Therefore, none of the provisions governing receiverships apply.[376]

Section 11.052 provides that the LLC, in winding up, must "cease to carry on its business, except to the extent necessary to wind up its business."[377] The LLC is required to send notice of its winding up to each "known claimant."[378] The LLC must collect and sell its property to the extent the property is not to be distributed in kind and "perform any other act required to wind up its business and affairs."[379] However, the court has broad authority to customize the winding up process.[380]

2. Lesser Remedies

Given that the court has discretion as to the winding up and termination order under section 11.314, the court should certainly have the equitable power to fashion a different remedy.[381] Unlike receiverships, which the Texas Supreme Court has now held are exclusively statutory proceedings,[382] dissolution proceedings are equitable in nature.[383] Moreover, section 11.054(3) empowers the

375. *See* Spiritas v. Davidoff, 459 S.W.3d 224, 235 (Tex. App. 5th 2015) ("Each of those three sections provides for the appointment of 'a person' in certain instances pertaining to the winding up of entities. [TEX. BUS. ORGS. CODE] §§ 11.054, 101.551, 152.702(a)(3). However, none of those sections contains the word 'receiver' or provides for the appointment of a 'receiver.' Even assuming without deciding the record shows the occurrence of an 'event requiring winding up,' we cannot agree with Davidoff that the appointment of a receiver was authorized by any of those three sections.").

376. BUS. ORGS. § 11.401 (Westlaw); CBIF Ltd. P'ship v. TGI Friday's Inc., No. 05-15-00157-CV, 2016 WL 7163849, at *11 (Tex. App. 5th Dec. 5, 2016).

377. BUS. ORGS. § 11.052(a)(1) (Westlaw).

378. *Id.* § 11.052(a)(2).

379. *Id.* §§ 11.052(a)(3)–(4).

380. *Id.* §§ 11.054(1), (3).

381. *E.g.*, in Percontino v. Camporeale, No. BER-C-5-05, 2005 WL 730234, at *3–4 (N.J. Super. Ct. Ch. Div. Mar. 24, 2005) (holding the common law and principles of equity supplemented the statute and permitted a lesser remedy; issuing an injunction granting the plaintiff access to the books; restraining any extraordinary transfers of assets or cash; and ordering the defendant to account for all cash received from the business).

382. *See* Ritchie v. Rupe, 443 S.W.3d 856, 872 (Tex. 2014) ("Former article 7.05 creates a single cause of action with a single remedy: an action for appointment of a rehabilitative receiver. *See* former art. 7.05; *see also* TEX. BUS. ORGS. CODE § 11.404."); *see also Ritchie* 443 S.W.3d at 880 ("As we consider existing statutory remedies, we are mindful of the principle that, when the Legislature has enacted a comprehensive statutory scheme, we will refrain from imposing additional claims or procedures that may upset the Legislature's careful balance of policies and interests.").

383. CBIF Ltd. P'ship v. TGI Friday's Inc., No. 05-15-00157-CV, 2016 WL 7163849, at *8 (Tex. App. 5th Dec. 5, 2016); *see also* Dunnagan v. Watson, 204 S.W.3d 30, 41 (Tex. App. 2d 2006) (characterizing a claim under the predecessor to section 11.314 as an "equitable cause of action for dissolution of the limited partnership").

court to "make any other order, direction, or inquiry that the circumstances may require."[384]

Professors Miller and Ragazzo have suggested that a situation "in which a judicial decree requiring winding up is available, it may be preferable to pursue a less extreme remedy."[385] Texas courts exercising their equitable powers undoubtedly have the authority to fashion appropriate remedies.[386] The Texas Supreme Court in *Patton v. Nicholas* held:

> Wisdom would seem to counsel tailoring the remedy to fit the particular case . . . . [E]quity may, by a combination of lesser remedies, including exercise of its practice of retaining jurisdiction for supervisory purposes and reserving the more severe measures as a final weapon against recalcitrance, accomplish much toward avoiding recurrent mismanagement or oppression on the part of a dominant and perverse majority stockholder or stockholder group.[387]

3. Buyout

In *Davis v. Sheerin*, the First Court of Appeals held: "[B]ased on the *Patton* holding that courts could order liquidation under their general equity powers in the absence of statutory authority, we hold that a court could order less harsh remedies under those same equity powers."[388] In that case, the court held that Texas courts "may decree a 'buy-out' in an appropriate case where less harsh remedies are inadequate to protect the rights of the parties."[389] One New York court noted that "Limited Liability Company Law does not expressly authorize a buyout in a dissolution proceeding," but nevertheless held, "in certain circumstances, a buyout may be an appropriate equitable remedy upon the dissolution of an LLC."[390]

While the Texas Supreme Court in *Ritchie* held that the buy-out remedy was not available under section 11.404 and that there

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384. BUS. ORGS. § 11.054(3) (Westlaw).

385. MILLER & RAGAZZO, 20 TEXAS PRACTICE SERIES, *supra* note 203, § 21:12.

386. *See* ERI Consulting Eng'rs, Inc. v. Swinnea, 318 S.W.3d 867, 872–75 (Tex. 2010); *see also Ritchie*, 443 S.W.3d at 873 ("Unlike the statute, which authorizes only a receivership, common-law causes of action, particularly those that invoke a court's equitable powers, often support a variety of remedies, and the same may be true of other statutes that authorize receivership.").

387. Patton v. Nicholas, 154 Tex. 385, 398 (Tex. 1955); *see also* Davis v. Sheerin, 754 S.W.2d 375, 380 (Tex. App. 1st 1988), *disapproved of on other grounds by Ritchie*, 443 S.W.3d at 899 (holding that "courts have equitable powers to fashion appropriate remedies where the majority shareholders have engaged in oppressive conduct").

388. *Davis*, 754 S.W.2d at 380.

389. *Id.*

390. Mizrahi v. Cohen, 961 N.Y.S.2d 538, 542 (N.Y. App. Div. 2013).

was no buy-out remedy based on a stand-alone common law cause of action for shareholder oppression, the court did not hold that a buy-out order was unavailable as an equitable remedy for other causes of action. [391] Nothing in the *Ritchie* opinion questions the equitable power to order a buy-out as stated in *Davis*. On the contrary, the *Ritchie* court expressly suggested the remedy might be available for breach of an informal fiduciary duty between shareholders arising from a relationship of trust and confidence, and it did not foreclose a buy-out order as part of a receiver's rehabilitation of a corporation.[392]

E. Trial

Whether the economic purpose of an LLC is likely to be unreasonably frustrated, or whether one member has engaged in conduct that makes it not reasonably practicable to remain in business with that member, or whether it is not reasonably practicable to carry on the LLC's business in conformity with its governing documents are fact issues that must be submitted to the jury.

> When contested fact issues must be resolved before a court can determine the expediency, necessity, or propriety of equitable relief, a party is entitled to have a jury resolve the disputed fact issues. Dissolution proceedings are equitable in nature and contested facts concerning a basis for dissolution are for the jury.[393]

In cases tried under section 11.314 and its predecessors, the jury has simply been charged to answer whether each test was met. For example, the jury in *CBIF Ltd. v. TGI Friday's Inc.* considered each of these tests, finding:

> The economic purpose of [the joint venture] had been unreasonably frustrated and likely would be frustrated in the future; CBIF engaged in conduct that made it not reasonably practicable to carry on the business of [the joint venture] in partnership with CBIF; and it was not reasonably practicable for the joint venture to carry on its business in conformity with its governing documents.[394]

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391. *Ritchie*, 443 S.W.3d at 877.

392. *Id.* at 874–76, 891–92,.

393. CBIF Ltd. P'ship v. TGI Friday's Inc., No. 05-15-00157-CV, 2017 WL 1455407, at *9 (Tex. App. 5th Apr. 21, 2017). *See* M.R. Champion, Inc. v. Mizell, 904 S.W.2d 617, 618 (Tex. 1995); State v. Tex. Pet Foods, Inc., 591 S.W.2d 800, 803 (Tex. 1979);

394. *CBIF Ltd. P'ship*, 2017 WL 1455407, at *7.

It is interesting to contemplate how a jury trial of a shareholder oppression fact pattern might play out using these jury questions. The court might instruct the jury as to what are the economic purposes of the LLC or what are the terms of the company agreement. Or those matters might be left to the jury to determine. What type of conduct would the jury be instructed about that would render it not reasonably practicable to continue doing business with a particular partner? Courts might very well instruct juries based on the definitions developed in shareholder oppression cases rather than leave the matter to their unbridled and uninstructed discretion.

How would the issues be presented to the jury? The language of the three tests does not seem to invite the business judgment rule as an affirmative defense. Bad conduct by the plaintiff would not seem to furnish a defense. If the actions of the defendant make it not reasonably practicable to carry on the business, bad conduct by the plaintiff would not change that situation. In fact, most defendants locked in serious dissension with their partners would have a hard time testifying that it is reasonably practicable to remain in business under the current situation—regardless of who was ultimately at fault.

Where the material facts are not disputed, Texas courts have also granted summary judgments under section 11.314.[395] It is also interesting to note that courts have held that the company itself is not a necessary party to a proceeding under section 11.314.[396]

V. CONCLUSION

How would *Kohannim v. Katoli* have come out under section 11.314? Probably much the same as under the shareholder oppression doctrine. The court of appeals affirmed the holding of oppression based on the failure to make distributions (while increasing unearned compensation to the defendant). The court specifically analyzed the LLC company agreement: "Regarding the distributions of profits, Article V of 360 Center's Regulations provides for the distribution of 'available cash' to members quarterly provided that the available cash is not needed for a reasonable working capital reserve."[397] Based on the plaintiff's general expectations and on the express language of the company

395. *See* Saks v. Broadway Coffeehouse LLC, No. 04-14-00734-CV, 2015 WL 6511192, at *5 (Tex. App. 4th Oct. 28, 2015); *see also* Hill v. Hill, 460 S.W.3d 751, 760 (Tex. App. 5th 2015).

396. *See* Matz v. Bennion, 961 S.W.2d 445, 454 (Tex. App. 1st 1997).

397. Kohannim v. Katoli, 440 S.W.3d 798, 813 (Tex. App. 8th 2013), *disapproved of by* Ritchie v. Rupe, 443 S.W.3d 856, 871 (Tex. 2014).

agreement, the court held that "she did indeed have a right to receive distributions."[398] A jury might easily have found that because of the defendant's refusal to comply with the express and implied terms of the company agreement, "it is not reasonably practicable to carry on the entity's business in conformity with its governing documents."[399] A jury might also find that the failure to make distributions caused "the economic purpose of the entity . . . likely to be unreasonably frustrated."[400] Additionally, the *Kohannim* court held that the defendant "engaged in wrongful conduct and exhibited a lack of fair dealing in the company's affairs to the prejudice" of the plaintiff.[401] Certainly, a jury could have found, based on these facts, that "another owner has engaged in conduct relating to the entity's business that makes it not reasonably practicable to carry on the business with that owner." A jury might very well find all three tests were satisfied as the jury did in *CBIF Ltd. v. TGI Friday's Inc.*[402]

The remedy under section 11.314 would likely be the same as it was under the shareholder oppression doctrine. The *Kohannim* court ordered the LLC to be wound up and sold, appointed a receiver to do so, and distributed the proceeds.[403] A court would have the same power under sections 11.314 and 11.054. The *Kohannim* court also fashioned a remedy to award additional funds out of the sale of assets to the plaintiff to compensate her for the damage done by the defendant.[404] Under section 11.054, the court in a section 11.314 dispute would have the power to make "any other order, direction, or inquiry that the circumstances may require."[405] The court would also have the discretion to order the majority member to buy out the minority member's ownership interest at a fair price determined by the court.

The shareholder oppression doctrine may be dead as an independent cause of action, but the interests and legal rights it sought to protect are real and are subject to the protection of other

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398. *Id.*

399. TEX. BUS. ORGS. CODE ANN. § 11.314 (West, Westlaw through 2017 Reg. Legis. Sess.).

400. *Id.*

401. *Kohannim*, 440 S.W.3d at 813.

402. No. 05-15-00157-CV, 2017 WL 1455407, at *7 (Tex. App. 5th Apr. 21, 2017); *see* M.R. Champion, Inc. v. Mizell, 904 S.W.2d at 618 (jury finding "not reasonably practicable to carry on the partnership business"); *see also* Dunnagan v. Watson, 204 S.W.3d 30, 39 (Tex. App. 2nd 2006) ("Question number eight asked the jury whether Dunnagan's actions rendered it not practicable for the limited partnership to continue.").

403. *See Kohannim*, 440 S.W.3d at 806–07, 817.

404. *Id.* at 806.

405. TEX. BUS. ORGS. CODE ANN. § 11.054 (West, Westlaw through 2017 Reg. Legis. Sess.).

laws, such as section 11.314. The cause of action and remedies available under section 11.314 may actually be broader than the former shareholder oppression doctrine. Conduct that makes it "not reasonably practicable to carry on the business with that owner" may well include conduct that is less egregious than the "burdensome, harsh, or wrongful conduct" standard required in shareholder oppression cases. In applying the section 11.314 cause of action and exercising their equitable powers to craft a remedy, courts should continue to draw on the experience and wisdom of shareholder oppression jurisprudence. If this analysis is correct and accepted by post-*Ritchie* courts, then the Texas Supreme Court's conclusion in *Ritchie* would be entirely correct: Existing legal duties and remedies are "sufficient"[406]—at least for Texas limited liability companies.

406. Ritchie v. Rupe, 443 S.W.3d 856, 888–89.