The Majority Rules:

Vulnerability of Minority Owners in Limited Partnerships

Minority shareholder oppression has long been recognized as a cause of action in Texas, routinely applied to close corporations and limited liability companies ("LLCs"). Yet no Texas court has considered -- and thus either applied or rejected -- this doctrine in the limited partnership ("LP") context. This article advocates that, based on the applicable case law and statues, the balance of factors strongly support the application of the minority oppression doctrine to LPs.

In *Davis v. Sheerin*, 754 S.W.2d 375, the court explained that "oppressive conduct" is an "expansive term…used to cover a multitude of situations dealing with improper conduct" by the majority owner(s).

A. Landmark Decision

In 1988, the Houston Court of Appeals decided *Davis v. Sheerin*, and became the first Texas court to recognize a cause of action for "oppressive conduct" by the majority against a minority shareholder.[1] There, the conduct at issue was a conspiracy by the majority owners of a close corporation to deprive a minority owner of his stock. Finding that such behavior was "oppressive conduct," the Court noted that these actions would substantially defeat, if not totally extinguish, any reasonable expectations the minority owner may have regarding his ownership of shares. The Court explained that oppressive conduct is an expansive term covering a multitude of situations involving improper conduct, regardless of whether or not traditional squeeze-out techniques or financial suppression take place.

B. Statutory Basis for Oppression Claims

Davis (and other early minority oppression cases) utilized the receivership provisions in Articles 7.05 and 7.06 of the Texas Business Corporations Act ("TBCA") to fashion the minority oppression cause of action. Specifically, the TBCA provides a cause of action for oppressive conduct (as well as remedies) to minority shareholders who establish illegal, oppressive, or fraudulent conduct by the majority. While the TBCA applies only to corporations, its receivership provisions have been re-codified in the Texas Business Organizations Code ("TBOC"), which applies to all domestic entities, including partnerships. The TBOC contains language that is nearly identical to the TBCA language used by the *Davis* Court to establish the oppression cause of action.[2]

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TBCA Article 7.05, which was found by the court in *Davis* to "provide a cause of action based on oppressive conduct," has been re-codified in TBOC § 11.404, which applies to limited partnerships.

As such, it appears that the question of whether the oppression cause of action exists in a LP context has been answered affirmatively by statute. If faced with an oppression suit involving a LP today, a Texas court, under *Davis* and the TBOC, would be hard-pressed to rule that oppression is *per se* inapplicable, because the basis for the minority oppression doctrine may now be found in the TBOC, which was enacted after *Davis* and applies to all domestic entities. Further, there is no Texas precedent limiting the minority oppression cause of action to close corporations or LLCs, and indeed several other states have found the cause of action applicable to LPs.[3]

C. Underlying Principles—Vulnerability and Lack of Exit Rights

The oppression doctrine is based on simple principles—a vulnerable minority may need protection where the majority owners rule the entity and the minority owners have no ready exit. In such a scenario, oppression could take many forms. For example, the majority could force a below-market sale of minority shares, misappropriate assets through transfers to a new entity that excludes the squeezed partner(s), or simply make ownership in the entity miserable for the minority owner. These considerations obviously apply equally to LPs as they do to LLCs and close corporations. Indeed, an oppressed limited partner (just as an oppressed shareholder or member) challenging the majority often finds himself in a grave dilemma—he can neither profitably leave nor safely stay.

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D. Remedy: Equitable Buy-Out

Per *Davis* and its progeny, the remedy in an oppression situation is an equitable buy-out of the oppressed minority's shares. This remedy is equally desirable in the LP context as a means to diffuse the minority owner's problem. Specifically, minority LP owners, like their LLC and close corporation counterparts, have no ready market for their shares, and if left to the whim of the majority, would likely be squeezed out, shut out, or bought out at far below market value. The equitable buy-out remedy both allows the majority to gain the control it apparently seeks through its oppressive conduct and gives the minority a ready and fair exit that it would otherwise lack.

Depending on the facts and circumstances, a minority-owner limited partner may not be able to alternatively recover under a breach of fiduciary duty theory.

E. Fiduciary Duties Owed to Limited Partners are Insufficient Protection

One argument used against the application of the minority oppression doctrine in a LP context is that fiduciary duties may provide an alternate theory of recovery, obviating the need for the equitable buy-out remedy. But this argument is flawed, as the minority owner may not always be able to recover under this alternate theory. First, it is unclear under Texas law whether and how far fiduciary duties extend between limited partners.[4] Second, some of the typical "squeeze out" techniques seen in oppression cases may not actually breach any fiduciary duties. For example, the termination of the minority owner's employment is a common step/squeeze out tactic taken by the majority in their attempt to gain total control of the entity, which is considered by the court when conducting an oppression analysis. This same act, however, does not necessarily breach a recognized fiduciary duty (if any such duty exists). Therefore, a minority LP owner may not be able to alternatively recover under a breach of fiduciary duty claim if an oppression claim is unavailable.

F. Conclusion

The basis and underlying principles of the minority oppression claim and corresponding buy-out remedy are equally applicable to LPs as they are to LLCs and close corporations. Such a claim is also consistent with Texas jurisprudence. Outside the oppression context, a minority LP owner has virtually no recourse when effectively squeezed out of the partnership in which he once had a voice.

[1] 754 S.W.2d 375 (Tex. App.—Houston [1st Dist.] 1988, writ denied).
[2] *Compare* Article 7.05(A)(1)(C) of the TBCA *with* §11.404(a)(1)(C) of the TBOC.
[3] *See, e.g.*, *Alloy v. Wills Family Trust*, 179 Md. App. 255, 303-04 (Md. Ct. Spec. App. 2008) (recognizing that partnerships, close corporations, and limited liability companies all present the problem of "illiquidity of the business interest [which] creates 'a breeding ground for majority…oppression of minority owners'"); *Muscarelle v. Castano*, 695 A.2d 330, 334 (N.J. Super. 1997) (upholding the appointment of a receiver over a limited partnership based upon the minority oppression doctrine); *Weiner v. Weiner Inter Vivos Trust*, No. 1:06-CV-642, 2008 U.S. Dist. LEXIS 21163, at *11 (W.D. Mich. Mar. 18, 2008) (finding that the plaintiff sufficiently alleged the defendant was "using his control over the [*partnerships*, corporations, and limited liability companies] to funnel property…to other entities that [the] [d]efendant control[led]," which was "sufficient to state a claim for minority oppression" against those partnerships, corporations, and limited liability companies).
[4] *Compare Zinda v. McCann St., Ltd.*, 178 S.W.3d 883, 890 (Tex. App.—Texarkana 2005, pet. denied) ("The relationship among the various parties was a [limited] partnership; thus, the appellees owed fiduciary duties to [their partner]") *with Crawford v. Ancira*, No. 04-96-00078-CV, 1997 Tex. App. LEXIS 2263, at *14 (Tex. App.—San Antonio Apr. 30, 1997, no pet.) ("a person's mere status as a limited partner is insufficient to create fiduciary duties").