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Supreme Court of Texas.
Michael T. WILLIS, Francie Willis, Urban Retreat of Houston, Inc., and Willis
Hite Enterprises, Inc., Petitioners,
v.
Dan DONNELLY, Respondent.
No. 04-0409.

November 17, 2005

Appearances:
Marie R. Yeates, Vinson & Elkins L.L.P., Houston, for Petitioners.
Jeffery T. Nobles, Beirne Maynard & Parsons, L.L.P., for Respondent.

Before:

Chief Justice Wallace B. Jefferson, Don R. Willett, Paul W. Green, Nathan L. Hecht, Dale Wainwright, Phil Johnson, Justices.

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SPEAKER: Oyez, oyez, oyez. The Honorable Supreme Court of Texas. All persons having business before the Honorable Supreme Court of Texas [inaudible] and give their attention towards the Court's council. God save the state of Texas [inaudible].

CHIEF JUSTICE JEFFERSON: Thank you. Please be seated. Good morning. The Court has three matters on its oral submission docket. Justice Hecht is sitting in each of these arguments but is unable to attend this morning. We have rearranged the order in order to accommodate the judges who are not sitting in the first case, and so the three matters in order of their appearance are: Docket number 04-0409, Michael T. Willis, Francie Willis, Urban Retreat of Houston, and Willis Hite Enterprises, Inc. v. Dan Donnelly from Harris County in the First Court of Appeals District. Justices O'Neill, Brister, and Medina are not sitting in that case. Number 04 0194, Emzy T. Barker and others v. Walter W. Eckman and others from Harris County in the First Court of Appeal District and 04-0432 Moki Mac River Expeditions v. Charles Drugg and Betsy Drugg and others from Dallas County in the Fifth Court of Appeals District. The Court has allotted 20 minutes per side in these matters and the Court will take a brief recess between each argument. All arguments should be completed before noon. The proceedings are being recorded and the arguments should be posted on the Court's Web site by the end of the day today. The Court is ready to hear argument in 04-0409 Michael T. Willis and others v. Dan Donnelly.

SPEAKER: May it please the Court. Ms. Marie R. Yeates will present

argument for the petitioners. Petitioners have reserved five minutes for rebuttal.

ORAL ARGUMENT OF MARIE R. YEATES ON BEHALF OF THE PETITIONER

MS. YEATES: May it please the Court, your Honors. My name is Marie Yeates and I represent the petitioners. Your Honors, the issue in this case is whether one who is not a shareholder in the corporation but is merely contractual promise shareholder status is owed of fiduciary duty by the controlling shareholder and a closely held corporation. Now, every court that has come close to addressing this issue have said their answer is no. All the cases they've cited in the chart and in our brief and even our opponents, the respondent, does not deny that the answer to the question is no. The respondent just says, "That's not the question" because the respondent continues that it was a shareholder at the time of the alleged breach of fiduciary duty. But the problem with that argument, your Honor, is it applies in the phase of several holdings of the Court of Appeals.

And if I could refer the Court to our time line, which is tab two in our oral argument exhibits, better on the bench, tab two, our time line. The first holding of the Court of Appeals that it flies in the face of [inaudible] of the duty, the contractual duty to make Mr. Donnelly a shareholder as a matter of law, that that breach gives rise to damages equal to the value of the shares that Mr. Donnelly was not given. And --

JUSTICE: Ms. -- a threshold question. Is there any dispute about whether Donnelly earned the right to conveyance of the stock?

MS. YEATES: Your Honor, with respect to the corporation's obligation to issue to the stock, the -- there is no dispute except for the fact that there was an agreement between Mr. Donnelly and Mr. Willis to postpone making him a shareholder. And that's the agreement that the Court of Appeals relies on to find that the obligations to make him a shareholder didn't accrue until November of '94. And that's really my third holding that their argument flies in the face of. The Court of Appeals says the obligation to make him a shareholder did not accrue, until November of 1994. That's the yellow bar on my time line, November 1994. And importantly, your Honors, the respondent does not contest that holding and we don't contest that holding. It's uncontested before this Court that the obligation to make Mr. Donnelly a shareholder accrued in November of 1994 and the reason for that is, the Court of Appeals says it was undisputed and Mr. Donnelly admitted, Mr. Willis testified that they agreed to postpone making him a shareholder so Mr. Willis could get the tax benefits of being a sole shareholder and they agreed to postpone it until the corporation turn the corner financially. And on this record, the corporation has never turned the corner financially, so the Court of Appeals holds that when Urban Retreat terminated Mr. Donnelly's employment that was a repudiation of the contract, Justice Willett, and that accrued the obligation to make him a shareholder, which had not accrued up till that time. And you see that's why their argument that he was a shareholder at the time of the alleged breaches of fiduciary duties doesn't make any sense because look at the breaches of fiduciary duties --

JUSTICE: What about these repeated -- allegedly, these repeated

verbal assurances and promises --

MS. YEATES: Right.

JUSTICE: -- that he would convey the stock?

MS. YEATES: Undisputed, according to the Court of Appeals and not contested by our opponent. Undisputed that it was agreed that they would delay making him a shareholder and that's why the Court of Appeals in its statute of limitations holding on breach of contracts says that cause of action accrued in November of 1994. And if I could point out, Justice Willett, without that holding, their claims probably would have been time-barred and that's probably why they're not contesting that holding. They need that holding so their contract claim won't be time-barred. But nevertheless, with the holding results in, is it the obligation to make him a shareholder doesn't accrue until November of 1994, that's the yellow bar. But the red boxes on my time line are the breaches of fiduciary duty.

According to the Court of Appeals, what are the breaches of fiduciary duty? Mr. Willis making loans to the corporation instead of capital contributions, that's the red boxes on my time line. Mr. Willis and Francie Willis purchasing the realty, that happened in 1992. Purchasing the realty and -- when the corporation had an option to purchase the realty, allegedly usurping the corporation's opportunity to purchase the realty, all of those red boxes which are the breaches of fiduciary duty occur prior to the time when the Court of Appeals holds the obligation to make him a shareholder had even accrued.

CHIEF JUSTICE JEFFERSON: So if you just have the right to stop but [inaudible] actually physically arrived in any fiduciary breaches don't apply?

MS. YEATES: Well, Chief Justice, he didn't have, according to the Court of Appeals, he didn't even have the legal right to the stock until November of 1994 because the Court of Appeals hold --

JUSTICE WAINWRIGHT: Well, your third bullet point here says, the calculation for breach of contract should reflect the value at the time of injury. That's the time of determination. Is that different from when the right to be a stockholder --

MS. YEATES: The date of injury --

JUSTICE WAINWRIGHT: -- occurred?

MS. YEATES: -- we agree with that part of the Court of Appeals' opinion, Justice Wainwright.

JUSTICE WAINWRIGHT: I know, you just said that but I'm --

MS. YEATES: The injury --

JUSTICE WAINWRIGHT: -- I'm asking if -- is there a difference between the determination of when the injury occurred or when the breach occurred versus the time when there was a right to be a shareholder.

MS. YEATES: No, you Honor, I would say that's the same point in time. And the right to be a shareholder, in this instance, understand unto the letter agreement that might have accrued earlier. But because of the undisputed agreement of the parties to delay that approval, to delay his right, according to the Court of Appeals, undisputed by the parties, gives right to the shares did not accrue until November of '94.

JUSTICE WAINWRIGHT: Did the parties agree that November 1994 was the date that the --

MS. YEATES: The parties --

JUSTICE WAINWRIGHT: -- Donnelly will receive the stock or was that a determination by the Court of Appeals?

MS. YEATES: -- the parties agreed the dissent that Mr. Donnelly

and Mr. Willis both testified that they had agreed to delay making him a shareholder.

JUSTICE WAINWRIGHT: But to what date?

MS. YEATES: And then the parties agree here before your Honors because nobody is contesting the Court of Appeals' holding that's the date when the shares were [inaudible].

JUSTICE WAINWRIGHT: I understand those two points.

MS. YEATES: Right.

JUSTICE WAINWRIGHT: Did the parties agree to delay the shareholder's status of Donnelly to a specific date or [inaudible] agreed to delay that time?

MS. YEATES: The specific date to extend [inaudible] was when the corporation has turned the corner financially, and the corporation has never turned the corner financially. And that's why the Court of Appeals holds that, yes, but when Urban Retreat repudiated the contract by firing Mr. Donnelly, by terminating his employment, that accrued, because of the repudiation of the contract, that accrued the obligation to make him a shareholder. That's the undisputed holding [inaudible].

JUSTICE: I thought that the amount of sales was what the triggering element was to make him a shareholder.

MS. YEATES: Your Honor, under the letter agreement, that's true but for the separate oral agreement of Mr. Donnelly and Mr. Willis to delay making him a shareholder until the corporation has turned the corner. And saying that, the Court of Appeals says it's undisputed, okay. And my opponent is not disputing that here. They don't dispute the accrual holding of the Court of Appeals. So -- but let me say, let's pretend he was a shareholder because I wanna answer that issue too. I don't wanna just stand on my argument that he wasn't a shareholder but I think that's exactly right, okay. But let's assume he was a shareholder. Let's take him outside of the corporation and let's put him inside the corporation and make him a minority shareholder. And then ask yourself the question, under Texas law, is there a direct fiduciary duty for closely held corporation? Is there a direct fiduciary duty owed by the controlling shareholder to a minority shareholder because that's the issue that they want, your Honors, to answer. And we believe the answer to that issue, properly understanding the Texas cases, is also no. Is also no. Now, why do I say that? Because if you look at the Texas cases that have recognized the fiduciary duty, they say this duty by the controlling shareholder to the minority shareholder only exist in limited circumstances. And what are those limited circumstances? It's that all situations where there is an injury to the minority shareholder, that is not -- that is not also an injury to the corporation.

Take your Honors' decision, this Court's decision in Patton v. -- I forgot the second name, the Patton case, it's cited - Nicholas, Patton v. Nicholas. That's the only Texas Supreme Court case either side has here on this issue. Malicious suppression of dividends, the controlling shareholder maliciously suppresses dividends. That's an injury to the minority shareholder but it's not an injury to the corporation. It's only an injury to the minority shareholder. And what did this Court said? An equitable remedy -- an equitable remedy to enjoin the controlling shareholder to issue its dividends was available. So, what are the limitations on this duty? It has to be an injury to the minority shareholder, not an injury to the corporation. And generally, it only gives rise to equitable relief. What's another case, Davis v. Sheerin, the first Court of Appeals' case cited in the brief. Malicious locking out, malicious attempt to push out the

minority shareholder. That's an injury only to the minority shareholder. It is not also an injury to the corporation, equitable remedy only, enjoying the controlling shareholder to buy out the minority shareholder. And this distinction that I'm positing, that I'm proposing to your Honors was beautifully laid out. I couldn't say it any better than Judge Al Cob said in the Schauteet case, Federal District Court Judge Al Cob, it's cited, your Honors, in our petition for review and I'm embarrassed to say it is not recited in our brief on the merits, so please don't miss it. It's in our petition for review, the Schauteet case.

And here's what Judge Al Cob says, Texas Courts have properly limited the scope of the majority shareholder's fiduciary duties because most abuses of majority control constitute breaches of fiduciary duty that the majority shareholder owes to the corporation, not to the individual shareholder directly. And in this case, in Schauteet, the alleged abuse of control was the use of corporate assets for the benefit of the majority shareholder, exactly what's being argued here. And Judge Cob goes on to say, these allegations, if taken as true, would constitute breaches of duty which the majority shareholder owed to the corporation, not to the minority shareholder. And whether the minority shareholder is damaged by the breach is irrelevant --

JUSTICE: What's the current status of URH and WHE? Are they defunct? Do they have assets [inaudible] --

MS. YEATES: I'm sorry, your Honor?

JUSTICE: What's the current status, financial status of the two entities, URH and WHE? Are they --

MS. YEATES: Your Honor, all I know --

JUSTICE: -- are they defunct or --

MS. YEATES: Oh, no, no. They're ongoing.

JUSTICE: -- financially viable?

MS. YEATES: They're ongoing entities, your Honor, but all I can tell you is what's in the appellant's record. And what's in the appellant record is, they were still losing money as of the end of the appellant record.

JUSTICE: Are you arguing that the companies aren't liable under the letter agreement?

MS. YEATES: No, your Honor, I'm not. When I get to the breach of contract claim, with respect to whether the companies were obligated to issue the stock. Now, the claim has to be remanded because it was tried under the wrong measure of damages. But I'm not arguing that the corporation is not liable for issuing the stock in the breach. It has to be retried. But I am gonna argue when I get to the breach of contract that Mike and Francie are not individually liable on the breach of contract. But for the fiduciary duty, I am arguing that there is, as a matter of law, no fiduciary duty owed at this circumstance by the controlling shareholder to the minority shareholder because of the nature of the injury that's alleged here and because of the nature of the abuse of control that's alleged here.

CHIEF JUSTICE JEFFERSON: Two questions.

MS. YEATES: Yes.

CHIEF JUSTICE JEFFERSON: Do you agree there's an equitable shareholder doctrine? And then the second, it is the equitable right to possess stock the same as actual ownership?

MS. YEATES: Okay. Yes, sir, I agree that there's an equitable title doctrine.

CHIEF JUSTICE JEFFERSON: Or is that -- is it in Texas? Have we

said that in Supreme Court?

MS. YEATES: The Neely case that they cited, the First Court of Appeals case comes the closest, your Honor. And basically, if you have -- if it was time to give him the stock, if he was entitled to the stock, he would have an equitable time. Now, your Honor, maybe I answered your question erroneously because I do not agree that even if he was an equitable owner of the stock, that he would be owed a fiduciary duty. You see, that's what they're arguing. They're trying to argue he had equitable title and therefore, he is owed a fiduciary duty. I don't care if he had legal title. My point is that under Schauteet and a correct analysis of the Texas cases, no fiduciary duty is owed for this type of injury. It's not an injury only to Mr. Donnelly. These alleged breaches of fiduciary duty where Mr. Willis usurps a corporate opportunity according to them 'cause he buys the land that the corporation had the option on or Mr. Willis doesn't make capital contributions, instead he makes loans to the corporation, that's an injury to the whole corporation. That's not an injury special to Mr. Donnelly. And that's why there's no direct fiduciary duty owed.

JUSTICE: What does the record show us about the -- the story behind the story on the crossing out of the name --

MS. YEATES: Your Honor --

JUSTICE: -- on the letter?

MS. YEATES: -- yes, sir. You're on the breach of contract claim. Let me talk about the breach of contract claim.

JUSTICE: Ms. Yeates, before you change gears, the equitable ownership doctrine [inaudible] stock, does that change in any way your analysis on the November '94 date?

MS. YEATES: No. And I'm glad you asked me that, Judge, because I meant to say that. Even if he had equitable title, you have to ask yourself when did he have equitable title. And under the Court of Appeals holding, he doesn't -- he's not entitled to the shares until the yellow point on the time line. He's not entitled to the shares until November of '94. So, even if he had equitable title and even if you thought that somehow gave him a fiduciary duty, he didn't have that until after all the breaches of fiduciary duty occurred. So, even if you accepted their equitable title argument, they run right into the fact that the accrual holding of the Court of Appeals means he wasn't entitled to the stock until November ' 94, and that's after the fiduciary breaches allegedly occurred. And beyond that, your Honor, my position is whether he's a legal minority shareholder or an equitable minority shareholder, for this type of breach, he's not in due of fiduciary duty from the controlling shareholder.

And one more point on that, we cited, your Honor, in our booklet, this Delaware law review article. It's a relatively new article. It's not in our briefs because it's new. But it's very helpful and I wish your Honors would look at it to Delaware Journal Corporate Law that does a survey across the nation of all the states that have addressed this issue in closely held corporations, and should a duty be owed by the controlling shareholder directly to a minority and puts Texas in the category of, no, Texas doesn't do that. Texas says there's a duty to the corporation but not to the minority.

JUSTICE WAINWRIGHT: But we haven't directly addressed that issue.

MS. YEATES: Well, your Honor, except to the extent of the Patton case. The Patton case which was the malicious suppression of dividends where this Court held that the duty was owed because that's an individual injury to the shareholder and not to the corporation.

JUSTICE WAINWRIGHT: Well, generally speaking, shareholders don't

owe each other duties -- do not owe each other duties.

MS. YEATES: Exactly.

JUSTICE WAINWRIGHT: Generally speaking, but there's Delaware case law in which controlling shareholders were determined to owe duties to other shareholders. We have not directly addressed that type of a question, not a specific claim or specific statutory claim, but the general duties owed between shareholders, if any given special circumstances or unusual situations.

MS. YEATES: I agree with that, your Honor, and if you look at that law review article that deals with the Delaware cases, and it points out that, really, if you look at the Delaware cases, they're really saying that a duty is owed by the controlling shareholder to the corporation but not individually to the individual shareholder.

JUSTICE WAINWRIGHT: Well, and the question raised here, one question is, if there's a duty, a contract put to decide the agreement to delay the share transfer for now, that the duty by contract for a person to receive shares --

MS. YEATES: Right.

JUSTICE WAINWRIGHT: -- and the controlling shareholder runs the corporation can determine when and if those shares are issued, or if they're not issued, then where do you draw that line? If the majority shareholders controlling the corporation and the allegation is precluding the issuance of shares that's owed, then it gets a little more complicated than just a black-and-white picture painted, don't they?

MS. YEATES: Well, it does, your Honor, except under the [inaudible] tort doctrine, DeLanney v. Southwestern Bell you have to asked yourself, do you wanna create a tort, a fiduciary duty tort giving rights to actual and punitive damages out of the breach of a contract to make him a shareholder? And remember, Judge Wainwright, even if he is a shareholder, we -- the -- our position is still that no fiduciary duties owed because of the nature of the injury here being not a special injury to him as a shareholder but an injury to the whole corporation. Judge, do you want me to answer Justice Willett's question?

CHIEF JUSTICE JEFFERSON: Would you do that on rebuttal please.

MS. YEATES: I'm sorry?

CHIEF JUSTICE JEFFERSON: Would you do that on rebuttal please.

MS. YEATES: You bet.

JUSTICE WAINWRIGHT: Give me the data that Delaware article is in.

MS. YEATES: Oh, yes your Honor. It's 2004. It's 29 Delaware Journal of Corporate Law, 377 and cited in our [inaudible]. Thank you.

CHIEF JUSTICE JEFFERSON: Thank you, Ms. Yeates. The Court is ready to hear argument from the respondent.

SPEAKER: May it please the Court. Mr. Jeffery Nobles will present argument for the respondent.

ORAL ARGUMENT OF JEFFERY T. NOBLES ON BEHALF OF THE RESPONDENT

MR. NOBLES: I'd like to take the time that I have to respond to Ms. Yeates' argument and also to cover as much as I can of other issues in the case. The argument that Mr. Donnelly was not a shareholder and did not have the status of a shareholder at the time he was terminated by Francie Willis from the corporation is really contrary to Texas Law.

The Neely case which we cited in our briefs on equitable title, if all of this Court's opinion in Patty v. Middleton, 1891 case that most of us studied in Texas Property Law which says that equitable title is the real title. Legal title is a shadow. There are cases in this state cited in our briefs, cases and other jurisdictions as well, but if held that equitable title will support a shareholder's right to bring a suit against the corporation in a derivative action, and I'll talk about the derivative proceeding issue in just a minute.

JUSTICE: Just another real quick.

JUSTICE: Is -- is it --

JUSTICE: Did the agreement, did the letter agreement by its terms obligate Mr. Willis to do anything individually?

MR. NOBLES: It did. Yes, it did your Honor. The agreement itself stated in the first paragraph that Mike Willis is a party to this agreement.

JUSTICE: He didn't sign the agreement?

MR. NOBLES: He did not sign the agreement. But he negotiated the agreement and the agreement has his name in it. There's testimony cited in our briefs. I don't have time for the record reference but I can provide that to the Court. It was Mr. Willis who said that he individually negotiated this on his individual behalf that Mr. Hite was his individual agent negotiating for him in his individual capacity. There was testimony at trial by Mr. Willis that he individually controlled the corporation and individually decided to breach the contract because he, quote, didn't like the deal anymore. There's hundreds of pages of briefs in this case but all these testimonies laid down on our briefs and I'll be happy to provide record references for these assertions after argument.

JUSTICE: But it is the whole point of a corporate is to avoid personal liability.

MR. NOBLES: That's correct. A couple of problems here, and I would -- I'm sorry -- Judge Johnson?

JUSTICE JOHNSON: Would you address the equitable ownership in regard to the November '94 date?

MR. NOBLES: Yes, I'll do it, your Honor. I'm happy to do that. Ms. Yeates' argument was based on the misquoted Court of Appeals' opinion. The Court of Appeals doesn't hold that his right to become a shareholder accrued in November of 1994. Furthermore, it doesn't say that Mr. Willis and Mr. Donnelly agreed that Mr. Donnelly's status as a shareholder would be delayed. The agreement was that stock will not be issued. [inaudible] of delivery of legal title will not be issued but there's no dispute in the record that the right to shareholder status accrued throughout the first few years of corporation and Mr. Donnelly moved his entire business into this new business that the Court of Appeals correctly held the contract was breached. But the Court of Appeals did not hold that the breach of the contract when Mr. Donnelly was terminated in November of 1994 was when his shareholder status arose. That makes no logical sense. And furthermore, it makes no real world sense because close corporations are small, informal as a record of this case shows; corporations that don't always do their paperwork correctly. That's one of the problems in this case. This corporation didn't do its paperwork right. Because of that, because Mr. Willis controlled the paperwork, he was allowed to use the benefit of 100 percent ownership in this S-corporation. So that he was able to derive tax benefits that were well in excess of $1 million at the time Mr. Donnelly was a shareholder in the corporation and would have had the right to share those tax benefits.

JUSTICE WAINWRIGHT: So what was the agreement between Willis and Donnelly on the delay, delay of issuance of the paper? Was it delay in shareholder's status?

MR. NOBLES: I didn't bring the Court of Appeals' opinion to the podium with me but I believe that it's at 118 S.W.3d, I believe it's page 27, I could be wrong, where there's a quote from the testimony in which Mr. Donnelly said that Mr. Willis asked about and agreed to allow him to delay issuing the stock. But there was no agreement that Mr. Donnelly status as a shareholder would be delayed. And that's the very important point here. In these close corporation settings, it's not a muniment of title that creates a fiduciary duty. It is a relationship, as courts have held in this state, when a minority shareholder has a reasonable expectation that things are gonna work in a certain way of the corporation.

Now, paraphrasing here, Davis v. Sheerin, First Court's very, very prominent decision in this area. When the minority shareholder's reasonable expectations are not met because of majority shareholder oppressive conduct that can be a breach of fiduciary duty. Davis v. Sheerin also has a second element of oppressive conduct and it's a disjunctive standard, not a conjunctive standard, either or, either a reasonable expectations are met or fair plays have met things in the nature of fiduciary duty.

In the Court of Appeals opinion, in my opinion, this is extremely [inaudible] in discussing the fiduciary duties that arise under Texas Law between majority shareholders and minority shareholders in closely held corporations.

CHIEF JUSTICE JEFFERSON: I have two questions for you. What is -- what is your definition of oppressive conduct and how was that proved in this case?

MR. NOBLES: The standard was set out in Davis v. Sheerin where Justice Camille Dunn in 1990 -- 1988, the First Court of Appeals synthesized case law from Texas and around the country and said, first, that oppressive conduct is shown when acts complained of has served to frustrate with the legitimate expectations of minority shareholders and were severe enough to warrant judicial relief.

The second, and this is a disjunctive, it's not an exclusive list, the second standard is a lack of probity, a lack of fair dealing, and a violation of fair play. And that is certainly what was meant in this case, albeit the Court of Appeal's opinion.

JUSTICE WAINWRIGHT: Those two standards are pretty touchy feeling, aren't they?

MR. NOBLES: Well, they've been -- they been --

JUSTICE WAINWRIGHT: Lack of probity and fair dealing --

MR. NOBLES: I will say this, Judge Wainwright --

JUSTICE WAINWRIGHT: -- that means expectations, how do we add meaning to that?

MR. NOBLES: Fifty cases have followed Davis v. Sheerin since it was decided and have had no difficulty applying that standard, both in finding oppressive conduct and finding that there was not oppressive conduct. And I think the short answer to your question is to give you the rule that I think the cases have established and the rule that this Court could adapt in this case and that is that in a close corporation, a majority owes a fiduciary duty to a minority when a controlling shareholder is in a position to dominate control of that minority shareholder's interest.

CHIEF JUSTICE JEFFERSON: Which is only the case, right?

MR. NOBLES: It can't always be the case. It's not -- it's a real

world [inaudible].

JUSTICE: What if it's never not?

MR. NOBLES: What is that?

JUSTICE: What if it's never not the situation?

MR. NOBLES: With a controlling shareholder?

JUSTICE: In a close corporation.

MR. NOBLES: Well, I would say that the converse is actually the issue that this circuit in a case that isn't cited in the briefs, the case called Halas v. Hill. I'll give you the cite in a post- submission letter. In that case there were 50 percent shareholders, so each were 50 percent shareholders and the undisputed testimony was that one of those guys dominated the control of the corporation and that testimony established a possibility of oppressive conduct through the breach of fiduciary duties.

JUSTICE WAINWRIGHT: So anytime a majority shareholder is in a position to control a closely held corporation, the majority shareholder owes fiduciary duties to the other shareholders.

MR. NOBLES: Well, there's a limitation.

JUSTICE: [inaudible]

MR. NOBLES: There's a limitation that the cases following Davis v. Sheerin, that applied and I'm thinking particularly at Willis v. Bydalek, a First Court opinion by Murry Cohen in 1999 and a more recent opinion from the Fourteenth Court called [inaudible] which is not published in S.W.3d, it was authored by Justice John Anderson on a panel that included Scott Brister. In both of those cases, the courts were careful to say that unless there is a self-dealing, a taking of a corporate opportunity for personal benefits, unless there's something like that or unless there's direct injury to a shareholder that the doctrine doesn't apply. And that's because the business judgment rule protects corporate officers especially in close corporation, but in any corporation from being sued for exercising their valid business judgment. But the limitation on the business judgment rule is that it is not available when a conflict of interest exist between within a transaction that the controlling shareholder is a --

JUSTICE: Mr. Nobles, I'm having trouble a little bit identifying specifically the specific breaches of fiduciary duty by Willis and how those breaches, alleged breaches harmed Mr. Donnelly. What harm is cited?

MR. NOBLES: The Fourteenth Court opinion lists several things --

JUSTICE: Right. And for example, the purchase of the realty, and how did that purchase harm URH if URH didn't have money to purchase the property itself?

MR. NOBLES: I'd like to answer that question, Judge Willett, and I think the best way to do that is to turn to the petitioners' exhibit folder. I don't know if you'll have a copy of this. It would be [inaudible] if they've gotten to it. I think the very best answer to that question is this, and it is glued to the front of tab 7 Article 5.14 Bill Texas BCA, derivative proceedings. It adopts the Model Business Corporation Act as our briefing has said. It also adopts the view of American Law Institute that in close corporations it doesn't matter. A close corporation is analogous to a partnership in which partners of fiduciary duties to each other. This statute, the BCA and the ALI article that are cited in our briefing, they all attempt to create a judicial backstop that protects and gives default rights to derivative into close -- to shareholders in closely held corporations. The Willises have never fairly responded to the language of the statute which says that the requirements for derivative proceedings don't apply

to close corporations and that the trial court has the discretion and the judgment, as what's exercised by the trial court in this case. The trial court has the ability to treat a derivative proceeding as a direct action and furthermore to provide that, a recovery in a direct or derivative proceeding by a shareholder may be paid either directly to the plaintiff or to the corporations necessary to protect the interest of the predators or other shareholders of the corporation. This statute has been applied by other states.

JUSTICE: Looks to me like the answer to it is that their responses is not effective.

MR. NOBLES: And that's incorrect, your Honor. Now, I wanna point that out because that's a very important oversight that Willises have made throughout this case. This statute was certainly in effect, that at the time of trial in this case, it was in effect two years before the trial -- before the time of trial in this case. There was some sloppy illegal research done at the Appellate Court level in this case in which the Willises argued that the statute was not yet effective. But that was a mistake. Court of Appeals solved this in its briefing that we filed at the court. But if you look at the session laws, that this red font, this mistaken red font is based on, the session laws don't say that this statute wasn't in effect in 1999. The session law say that it was effective on September 1st of 1997. At the very end of a very long overhauled Business Corporation Act and other business organization statutes, at the very end of it, there is a provision that the First Court has cited in another case that says that this statute doesn't apply the lawsuits that have already been filed up by the time the statute is effective. But that provision doesn't apply to this statute, it applies to the Revised Partnership Act, and I'll give you the cite to that in a post-submission letter.

This statute was in effect, the Revised Partnership Act, which for the first time created a right for a limited partner to go to a derivative action. It was in effect, but this statute, it was most certainly in effect at the time of trial in this case. The Willises counsel at trial handed the trial judge a copy of the statute and he told them on the record, Volume 12, I can't remember the page number, that I'm well aware of the requirements in derivative proceedings. This case did not have to be filed as derivative proceeding because closed corporations in Texas are not subject to those requirements. And furthermore, trial courts in Texas had the discretion. As the legislature has said, as the ALI has said, as the Model of Business Corporation Act all hold, the trial court has the discretion to say that in a closed corporation, particularly an S-corporation like this one which is the flimsiest form of corporate vehicle, trial courts have the discretion to treat damages that accrued to the corporation or to the minority shareholder as either a direct or as a derivative damage and that the shareholder can receive it directly, so long as other shareholders aren't prejudiced and so long as creditors aren't prejudiced.

And in this case as we've argued in our briefs, neither creditors nor shareholders were prejudiced by an award of damages to this minority shareholder, Dan Donnelly. So, my answer to your question, Judge Green, is that in Texas, in close corporations, there's no longer a mysterious cloud over the difference between direct actions and derivative actions in closely held corporations. And this has been an issue that has been written on many times in Texas. I have not seen the Delaware article. I've seen it actually, it wasn't cited before the day I was prepared to argue about it. But there's a lot more Texas

jurisprudence and Texas Law Review commentary that talks about why close corporations in Texas recognize a majority-minority fiduciary duties.

I would say this, Davis v. Sheerin itself, the case that the Willis has cited in the argument they just made in this Court, Davis v. Sheerin itself in 1988 involved damages that were owed to the corporation through corporate usurpation as well as oppressive conduct that refer to minority shareholder. In this case, we have both things and they're clearly in support of the evidence where breach of fiduciary duty findings on many, many levels in this case.

I'd like to touch very, very shortly because I'm not sure the lights are working right, but the damages issue in this case is very important. This case has been going on for ten years. The jury heard evidence of damages and gave answers to breach of contract and breach of fiduciary duty findings that showed that the jury believed that there are breaches of contract and breaches of fiduciary duty. There were pleadings. We filed a brief that the Court may had an extension of time [inaudible], we filed a brief this week that explains this argument better than I can in the limited time I had, but there were distinct acts of wrongdoing on the part of the Willises. They were distinct and separate injuries and separate and distinct damages. The jury came back and gave damage findings that were less than were argued for in closing argument by trial counsel. Trial counsel asked for I think $2.8 million and in a very quick argument said, breach of fiduciary duty, the same.

But the jury didn't come back with an award of 2.0 or whatever the number was, it came back with this very precise number of $1.707 million because they have a 30-cent number. Those damage findings are rational. The trial court entertained much briefing on this issue, much argument on the damage issues for almost a year post-verdict, and allowed a recovery of breach of fiduciary duty damages which clearly were separate and distinct from breach of contract damages for the reasons explained in our briefing. The fact that the numbers were the same, probably is a reflection of the fact that counsel said the same. That probably is true but that is not a reason to remand this case for a new trial on damages as the Willises request. That would be a waste of judicial resources of the three weeks of trial of the nearly one year of post-judgment briefing. In the six years of appellate work that we had in this case because the Willises' only argument is look at the numbers. But the numbers are rationally-based. The damages for breach of contract are based on expert testimony that the value of stock in this corporation, if you don't include the real estate, is about $1.7 million. That's where the breach of contract finding came from.

The breach of fiduciary duty damages was supported by evidence on the record of -- I think it was morning when I woke up -- for about $2.55 million in corporate opportunities that were usurp by the Willises including this real estate which had a market value of at least $2.436 million at the time of trial, as well as $1.8 million in tax benefits that Mr. Willis used for himself, as well as 300 and something thousand dollars of rent that the Willises take for themselves from the corporation, and some other damage numbers they referred to in the Court of Appeals opinion in our briefing. And it would be a tremendous waste of judicial resources to remand this case for a new trial when there is evidence that supports the findings, when the trial court and the Court of Appeals looked very carefully at this record and found that there was evidence to support both findings. There's an example of the restatement of judges in which -- the

restatement of judgments in which a party owe someone money -- my time is up. I'm sorry.

CHIEF JUSTICE JEFFERSON: Any further questions? Thank you, Counsel.

MR. NOBLES: Thank you, your Honor.

REBUTTAL ARGUMENT OF MARIE R. YEATES ON BEHALF OF THE PETITIONER

MS. YEATES: Your Honors, on the statute 5.14 now, it doesn't matter if that's effective. The statute says that you can get rid of the prerequisite agreement derivative claim and bring it as if it's a direct claim, but it still has to raise the kind of duty that's raised in a derivative claim. The statute's entitled derivative claims and it talks about in a close corporation under paragraph L. It says that in a close corporation, if certain protections for creditors and other shareholders are taken care of, you can have -- bring it yourself as a shareholder but you have to be bringing what amounts to as far as duty-wise of derivative claim that you then can act like it's a direct claim. And how do I know that? Look at the ALI, it's a statute that they quote in their brief, at page 28, and they say this statute is just like the American Law Institute, listen to the language there. We could treat it as a direct action if it raises derivative claims. It raises derivative claims. And what's a derivative claim? That's where there's a duty owed directly to the corporation that the shareholder is bringing. Look at the cause of action that was submitted to this jury. This jury was not asked if Mike Willis breached a fiduciary duty to the corporation. He -- they were asked if Mike Willis breached a fiduciary duty directly to Mr. Donnelly, directly to the individual shareholder.

And chief justice asked, what's the limitation on the oppressive doctrine. The limitation is if you look at all the cases including Willis v. Bydalek, is it's an injury that's alleged to the minority shareholder that's not shared by the rest of the corporation. In Willis v. Bydalek, the shareholder, the minority shareholder was locked out. That's not an injury to the corporation. That's an injury to him separately. Now, as far as the equitable title doctrine, your Honor, their equitable title doctrine argument is also inconsistent with the measure of damages that they want for breach of contract.

CHIEF JUSTICE JEFFERSON: Well, did you preserve error? Did you submit substantially correct --

MS. YEATES: On this one?

CHIEF JUSTICE JEFFERSON: -- measure of damages?

MS. YEATES: On the measure of damages?

CHIEF JUSTICE JEFFERSON: Yeah.

MS. YEATES: With respect to the breach of contract measure of damages, your Honor, the Court of Appeals don't even say we didn't preserve that. I mean, even the Court of Appeals said we made a specific charge objection that said you have erroneously charged the jury to calculate breach of contract damages based on the other matters related to shares and that provision doesn't apply. And the Court of Appeals on its face said, when you can look at it and see it doesn't apply, that's clearly preserved.

CHIEF JUSTICE JEFFERSON: And how about the breach of fiduciary duty?

MS. YEATES: On the breach of fiduciary duty damages, your Honor,

it is preserved because we again argued that the measure of damages submitted, excuse me -- that there was no measure of damages submitted and that they're needed to be a measure of damages and that we did suggest language. We made a request that would've been a fair market value type measure, so we think that is preserved. But your Honor, just going to Counsel's argument about being the same damages, remember that the Court of Appeals said the fiduciary damages were the value of the real estate that Mr. Willis purchased and the value of the loans. Look at the question that was put to the jury on statute of limitations on this. Did the breach of fiduciary duty occur prior to August 1993? And the jury said, no. The jury said no. Look at the time line. The loans and the real estate, that all happened before August of 1993. This jury was not answering fiduciary duty damages based on the loans and the real estate purchase. They said they weren't. And if the Court of Appeals concocted that kind of [inaudible], nobody was arguing that that was the measure.

JUSTICE: [inaudible] back to the contract claim --

MS. YEATES: I need to go back to Justice Willett's on the contract claim. You're exactly right. Mr. Willis scratched the signature line off and in front of Mr. Donnelly, Mr. Donnelly admitted Mr. Willis would sign it and Judge, Francie wouldn't even named. I mean, Francie's name appears nowhere in that contract. There's no evidence in this record that contract was made on behalf of Francie.

JUSTICE: Is there any record [inaudible] that indicates why the Willis line was crossed-out?

MS. YEATES: Right. Because Mr. Willis didn't wanna be personally or individually or party and responsible for the contract and to answer another question that you've raised Judge, the contract on its phase puts no obligation on Mike, certainly not on Francie Willis who didn't even mention in the contract to issue the shares or to pay Mr. Donnelly a salary. So, you're exactly right. This contract on its phase does not impose individually on either of the Willises individually the obligation for which they're being held liable for breach of contract without a finding a breach, without a finding of breach. And Judge Willet, you asked the question of or is it the whole point of incorporating to get protection for individual liability. That's exactly what this Court of Appeal's decision implies in the phase of. Because it makes the controlling shareholder individually liable for breach of contract without a breach finding against them individually without an alter ego finding, there's just automatically liable. That's why we believe the individual breach of contract claim against Mike and Francie Willis has to be rendered, and take nothing in the fiduciary should be rendered to take nothing because there's no duty owed directly to the minority shareholder.

CHIEF JUSTICE JEFFERSON: Thank you Ms. Yeates. The case is submitted and the Court will now take a brief recess.

SPEAKER: All rise.

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