IN THE COURT OF APPEALS OF TENNESSEE
AT NASHVILLE
July 12, 2005 Session

TERI LYNN COCHRAN v. L.V.R. & R.C., INC., ET AL.

Direct Appeal from the Circuit Court for Coffee County
No. 33,082 Gerald L. Ewell, Sr., Judge

No. M2004-01382-COA-R3-CV - Filed September 12, 2005

Plaintiff brought an action for corporate dissolution pursuant to Tennessee Code Annotated § 48-24-301(2)(B). The trial court granted Defendants' motion to dismiss for failure to state a claim. We affirm in part, reverse in part and remand for further proceedings.

Tenn. R. App. P. 3 Appeal as of Right; Judgment of the Circuit Court Affirmed in part; Reversed in part and Remanded

DAVID R. FARMER, J., delivered the opinion of the court, in which W. FRANK CRAWFORD, P.J., W.S., and HOLLY M. KIRBY, J., joined.

Robert L. Huskey, Manchester, Tennessee, for the appellant, Teri Lynn Cochran.

Josh A. McCreary, Murfreesboro, Tennessee, for the appellees, L.V.R. and R.C., Inc., Rbea J. Cochran and Larry Vickers d/a/b The Home Place.

OPINION

Plaintiff Teri Lynn Cochran (Ms. Cochran) and Defendants Reba J. Cochran and Larry Vickers (collectively, Defendants) are the three sole stockholders of a business operated as The Home Place. Reba Cochran is Ms. Cochran's mother-in-law; Larry Vickers is Reba Cochran's brother. The Home Place was purchased as an existing business in 1994 by Ms. Cochran's husband and Defendants. Ms. Cochran inherited a 45% ownership interest in The Home Place upon the death of her husband in 1997.

On October 2, 2003, Plaintiff, commenced an action against Defendants and prayed for corporate dissolution under Tennessee Code Annotated § 48-24-301(2) or, in the alternative, if the business should be considered a partnership, dissolution under Tennessee Code Annotated § 61-1-801. In her complaint, Ms. Cochran alleged that, although The Home Place was incorporated, it was operated as a family business. Ms. Cochran further alleged that, prior to his death, her husband and his mother operated the business and Mr. Vickers was not involved in the

business affairs. She also alleged that, following the death of her husband, from 1997-2001 Defendants paid her for her ownership interest in the business. She asserted that she "continued to share in the proceeds of the business but at a reduced level enjoyed by her husband." She alleged that from 1997 until 2001 she received approximately $18,000 per year, that in 2001 she received $700, and that she has received nothing since 2001.

Ms. Cochran alleged in her complaint that, although she owns 45% of the business, "since Reba J. Cochran owns the other 45% and has the support of her brother with his 10% they control the corporation and defeat [her] 45% interest in that corporation." She asserted that "the corporation should be dissolved because of the oppressive conduct of the other stockholders as contemplated under subsection (b)" of the statute. She alleged that the business has experienced no decline and that Defendants ceased payments to her for personal reasons. Ms. Cochran stated that the only reason Defendants ceased payments to her for her ownership interest was that, four years after her husband's death, she had begun to date despite her mother-in-law's objections.

On November 21, 2003, Defendants filed a motion to dismiss. In March 2004, the trial court granted the motion, holding that Ms. Cochran had failed to allege conduct which would entitle her to relief. On March 31, 2004, Ms. Cochran filed a motion to amend her complaint, alleging Defendants had acted in bad faith and had breached their fiduciary duty. She also filed a motion to alter or amend the court's ruling based on her motion to amend her complaint. In her motion, Ms. Cochran relied on *Hall v. Tennessee Dressed Beef Co.*, 957 S.W.2d 536 (Tenn. 1997), for the proposition that she has a cause of action for breach of fiduciary duty. The trial court denied the motion on April 7, 2004, and opined that even if the motion to amend were granted, there still would be no basis for relief. Ms. Cochran filed a timely notice of appeal to this Court.

Issue Presented

Ms. Cochran presents the issue for review by this Court as whether the trial court erred by holding, in substance, that a stockholder cannot have a cause of action against a fellow stockholder for breach of fiduciary duty. Defendants present the issue as whether the trial court erred by dismissing Ms. Cochran's complaint for failure to state a claim under Tennessee Code Annotated § 48-24-301(2).

Standard of Review

A motion to dismiss for failure to state a claim under Tennessee Rule of Civil Procedure 12.02(6) tests the legal sufficiency of the complaint itself. *Cook v. Spinnakers of Rivergate, Inc.*, 878 S.W.2d 934, 938 (Tenn. 1994). The premise underlying a 12.02(6) motion is that the allegations of the complaint, if considered true, are not sufficient to constitute a cause of action as a matter of law. *Id.* A motion to dismiss should only be granted if "it appears that the plaintiff can establish no facts supporting the claim that would warrant relief." *Doe v. Sundquist*, 2 S.W.3d 919, 922 (Tenn. 1999).

When reviewing a complaint to determine whether a Rule12.02(6) motion should be granted, the court must construe the complaint liberally in favor of the plaintiff. *Stein v.*

Davidson Hotel Co., 945 S.W.2d 714, 716 (Tenn. 1997). The court must regard all factual allegations in the complaint as true. *Id*. It also must give the plaintiff the benefit of all inferences that can be reasonably drawn from those facts. *Utley v. Tennessee Dep't of Corr.*, 118 S.W.3d 705, 712 (Tenn. Ct. App. 2003). The court must consider only the complaint, looking to its substance rather than form. *Id.* We review a trial court's award of a motion to dismiss *de novo*, with no presumption of correctness. *Stein*, 945 S.W.2d at 716.

Analysis

We begin our analysis by noting that Ms. Cochran brought her action for corporate dissolution under Tennessee Code Annotated § 48-24-301(2) and, in the alternative, under § 61-1-801. Section 61-1-801 pertains to the dissolution of a partnership, however, and, because this entity is not a partnership, is inapplicable in this case. The trial court granted Defendants' motion to dismiss for failure to state a claim on March 15, 2004. On March 31, 2004, Ms. Cochran filed a motion to alter or amend and a motion to amend her complaint to include claims of breach of fiduciary duty. The trial court denied Ms. Cochran's motion to alter or amend the judgment and further denied her motion to amend her complaint, stating: "[t]here is no pleading to amend inasmuch as the cause has been dismissed."

We agree with the trial court that, after it dismissed Ms. Cochran's complaint, there was no complaint left before the court to amend. However, as discussed below, an allegation of oppressive conduct under § 48-24-301(2)(B) essentially alleges a breach of fiduciary duty on the part of controlling or majority shareholders. Therefore, whether stated in terms of fiduciary duty under *Hall v. Tennessee Dressed Beef* or oppressive conduct under § 48-24-301, Ms. Cochran has stated substantially the same cause of action.

We turn next to whether Ms. Cochran has asserted a cause of action for dissolution under § 48-24-301(2). Section 48-24-301(2) provides, in pertinent part:

> Any court of record with proper venue in accordance with § 48-24-302 may dissolve a corporation:
> . . . .
> (2) In a proceeding by a shareholder if it is established that:
> (A) The directors are deadlocked in the management of the corporate affairs, the shareholders are unable to break the deadlock, and irreparable injury to the corporation is threatened or being suffered, or the business and affairs of the corporation can no longer be conducted to the advantage of the shareholders generally, because of the deadlock;
> (B) The directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent;
> (C) The shareholders are deadlocked in voting power and have failed, for a period that includes at least two (2) consecutive annual meeting dates, to elect directors; or
> (D) The corporate assets are being misapplied or wasted[.]

Tenn. Code Ann. § 48-24-301(2)(2002).

Ms. Cochran asserts that dissolution is proper under sub-section (B) of this section because Defendants' actions have been oppressive. She asserts that The Home Place is operated as a family business and that, because Defendants control the business and have refused to continue payments based on her ownership interest, her shares in the corporation are worthless. In her complaint, Ms. Cochran alleges she has never worked in the business and that payments made to her were not wages, regardless of how they may have been recorded in the business records. Further, Ms. Cochran does not allege that the business paid dividends to some shareholders but not to others. Finally, Ms. Cochran contends that the business has experienced no loss, but that Defendants ceased payments to her for purely personal reasons. She submits that Defendants' acts are oppressive for the purposes of § 48-24-301(2)(B)(alternately, "the section") and that corporate dissolution is, therefore, appropriate under the section. Thus, this case presents the question of what constitutes oppressive conduct such that an action for dissolution may be maintained under § 48-24-301(2)(B).

The parties cite no Tennessee cases defining "oppressive" for the purposes of the section, and we find none. Courts in sister jurisdictions construing "oppressive" acts for the purposes of corporate dissolution of close corporations under provisions similar to § 48-24-301(2)(B), however, have noted that the general characteristics typical of a close corporation, like the corporation in this case, are 1) few shareholders; 2) the shareholders know each other, usually live in the same area, and are familiar with each other's skills; 3) all or most of the shareholders are active in the business; and 4) there is no market established for the corporate stock. *Balvik v. Sylvester*, 411 N.W.2d 383, 386 (N.D. 1987)(citing 1 F. O'Neal and R. Thompson, *O'Neal's Close Corporations* § 1.07 (3d ed. 1987)). Additionally, shareholders of a close corporation generally expect to be actively involved in corporate management and operation. *E.g., id.* They generally are employed by the corporation and often receive a return on their investment in the form of salary rather than stock dividends. *Id*. (quoting 1 F. O'Neal and R. Thompson). "Earnings of a close corporation, often are distributed in major part in salaries, bonuses and retirement benefits, a fact which illustrates how some business policies in a close corporation are more likely than in a publicly held corporation to be determined by tax consequences." *Id.* (quoting1 F. O'Neal and R. Thompson). Although technically a corporation, a close held corporation often is owned by family members and operated as a family business. *See, e.g., id.*; *Maschmeier v. Southside Press, Ltd.*, 435 N.W.2d 377 (Iowa App. 1988), *as corrected* (Feb. 10, 1989); *Gidwitz v. Lanzit Corrugated Box Co.*, 170 N.E.2d 131 (Ill. 1960).

At the courts have noted, the market for the stock of a close corporation is limited, and a minority shareholder's interest in the corporation can be "held hostage" by the controlling interests. *Balvik,* 411 N.W.2d at 386. Unlike members of a partnership, shareholders of a close corporation cannot dissolve the enterprise at will. *Muellenberg v. Bikon Corp.*, 669 A.2d 1382, 1386 (N.J. 1996). Additionally, unlike shareholders in a publically held corporation, they cannot sell their shares on the market. *Id.* As the Supreme Court of New Jersey aptly phrased it, a minority shareholder who challenges the majority in a close corporation is "on the horns of a dilemma." *Id.* He "can neither profitably leave nor safely stay with the corporation," and the only real prospective buyer of his shares is the majority shareholder. *Id.* In close corporations, moreover, the principles of majority rule and the business judgment rule are of limited validity.

Id. (quoting F. Hodge O'Neal, *Close Corporations: Existing Legislation and Recommended Reform*, 33 *Bus.Law* 873, 884 (1978)).

Because of the nature of the close corporation, majority shareholders in a close corporation can use oppressive tactics to "freeze out" a minority shareholder. *Balvik v. Sylvester,* 411 N.W.2d 383, 386 (N.D. 1987). Freeze-out actions are those which deprive the minority shareholder of an opportunity to participate in the business and deny her a fair return on her investment. *Id.*; *Maschmeier*, 435 N.W.2d at 381. For example, where a minority shareholder is not employed by the corporation, controlling shareholders may elect not to pay dividends but receive a substantial return from the corporation in the form of salaries, "effectively depriv[ing] the minority shareholder of every economic benefit that she derives from the corporation." *Balvik* 411 N.W.2d at 387 (quoting D. MacDonald, *Corporate Behavior and the Minority Shareholder: Contrasting Interpretations of Section 10-19.1-115 of the North Dakota Century Code*, 62 N.D.L.Rev. 155, 164-65 (1986)).

It is well-established, however, that the officers and directors of every corporation owe the corporation and its shareholders a fiduciary duty. *Summers v. Cherokee Children & Family Servs., Inc.*, 112 S.W.3d 486, 504 (Tenn. Ct. App. 2002). Additionally, "the shareholders of a close corporation share a fiduciary relationship which imposes upon all shareholders the duty to act in good faith and fairness with regard to their respective interests as shareholders." *Hall v. Tenn. Dressed Beef Co.*, 957 S.W.2d 536, 541 (Tenn. 1997)(quoting *Nelson v. Martin and Gammon*, 958 S.W.2d 643, 650 (Tenn. 1997)). Moreover, as a result of the similarities between the relationship of shareholders in a close corporation and partners in a partnership, courts have held that the fiduciary duties of shareholders of a close corporation are akin to the fiduciary duties of good faith and loyalty charged to partners. *Balvik,* 411 N.W.2d at 387; *Maschmeier v. Southside Press, Ltd.*, 435 N.W.2d 377, 380 (Iowa App. 1988), *as corrected* (Feb. 10, 1989); *see Baker v. Commercial Body Builders*, 507 P.2d 387, 393-94 (Or. 1973); *see Anderson v. Wilder*, No. E2003-00460-COA-R3-CV, 2003 WL 22768666, at *5 (Tenn. Ct. App. Nov. 21, 2003) (*no perm. app. filed*) (citing *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 661 (Mass. 1976)). "Stockholders in close corporations must discharge their management and stockholder responsibilities in conformity with this strict good faith standard. They may not act out of avarice, expediency or self-interest in derogation of their duty of loyalty to the other stockholders and to the corporation." *Balvik v. Sylvester*, 411 N.W.2d 383, 387 (N.D. 1987)(quoting *Donahue v. Rodd Electrotype Co. of New England, Inc.*, 328 N.E.2d 505, 515 (Mass. 1975)).

"Oppressive conduct" is a broad term and includes conduct that is not necessarily illegal or fraudulent. *E.g., Balvik*, 411 N.W.2d at 386; *Maschmeier*, 435 N.W.2d at 380. We agree that, in light of the nature of close corporations and the duties charged to the shareholders, whether the controlling shareholders have engaged in oppressive conduct can be measured in terms of fiduciary duties and the minority shareholder's "reasonable expectations." *See id.* at 387; *Maschmeier v. Southside Press, Ltd.*, 435 N.W.2d 377, 380 (Iowa App. 1988), *as corrected* (Feb. 10, 1989). Oppressive conduct is conduct whereby the majority attempts to freeze or squeeze the minority shareholder(s) out of the business, depriving the minority of its right to participate in the management of the corporation and/or their right to benefit financially in the form of reasonable compensation or dividends. Oppressive conduct is conduct which lacks "probity and fair dealing with the affairs of a company to the prejudice of some of its members, or a visual

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." *Maschmeier*, 435 N.W.2d at 380 (quoting *Baker v. Commercial Body Builders, Inc.*, 507 P.2d 387, 393 (1973)). It is conduct whereby the controlling shareholders operate the business for their sole benefit and to the detriment of minority shareholders. *Baker*, 507 P. 2d at 394. Oppressive conduct includes conduct whereby the controlling shareholders/directors do not declare dividends, but provide themselves with high compensation and "enjoy[] ... the fullest ... 'patronage' which corporate control entails, leaving minority shareholders who do not hold corporate office with the choice of getting little or no return on their investment for an indefinite period of time or selling out to the majority stockholders at whatever price they will offer." *Maschmeier*, 435 N.W.2d at 380 (citing *Baker*, 507 P.2d at 392). Of course, the majority or controlling shareholders may offer very little for the minority's shares, or refuse to buy them altogether, thereby rendering the essentially unmarketable shares valueless.[1]

Additionally, although a finding of oppressive conduct does not require a finding of illegal or fraudulent acts, it does require a finding of more than merely poor business judgment on the part of the controlling shareholders. Oppressive acts thwart those expectations of the minority shareholder that are objectively reasonable. *Balvik v. Sylvester*, 411 N.W.2d 383, 387 (N.D. 1987). An allegation of oppressive conduct will not suffice to extricate a minority shareholder from an investment that simply has turned out to be a bad choice. *See Baker*, 507 P.2d at 394. Whether the majority or controlling shareholders have engaged in oppressive conduct is a fact intensive inquiry requiring an examination of the objectively reasonable expectations of the complaining shareholder and the actions of the defendants measured in terms of their fiduciary duties and in light of the totality of the circumstances.

Corporate dissolution is a drastic measure, moreover, and is not the only remedy available to the court when it finds oppressive conduct. We agree with courts in sister jurisdictions that a forced dissolution sometimes permits minority shareholders to engage in "retaliatory oppression." *Balvik*, 411 N.W.2d at 388 (citing *Alaska Plastics Inc. v. Coppock*, 621 P.2d 270 (Alaska 1980); *Baker*, 507 P.2d at 395-396. Additionally, the Tennessee Code provides: "[i]f after a hearing the court determines that one (1) or more grounds for judicial dissolution described in § 48-24-301 exist, it *may* enter a decree dissolving the corporation and specifying the effective date of the dissolution[.]" Tenn. Code Ann. § 48-24-304(a)(2002)(emphasis added). Therefore, although the Tennessee Code authorizes the court to order dissolution of the corporation upon a finding of one of the statutory grounds, it does not require it to do so. *Id.; Miller v. Miller Bros. Farms, Inc.*, Nos. 03A01-9808-CH-00294, 03A01-9808-CH-00295, 03A01-9808-CH-00296, 1999 WL 894206, at *3 (Tenn. Ct. App. Oct. 15, 1999)(*perm. app. denied* Feb. 28, 2000). Courts considering remedies within the court's equitable discretion have noted that alternative remedies include: (a) an order for dissolution of the corporation at a specified future date, effective only if the stockholders fail to resolve their differences prior to that date; (b) retention of the case by the court and the appointment of a

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[1] We are mindful that, in the present case, Ms. Cochran did not individually invest in The Home Place, but inherited the shares from her husband. We find this to be of little consequence to her position as minority shareholder, however. *See Maschmeier v. Southside Press, Ltd.*, 435 N.W.2d 377 (Iowa App. 1988), *as corrected* (Feb. 10, 1989)(finding oppressive conduct by controlling shareholders against shareholders who had been gifted shares.)

receiver, not for dissolution, but to continue the operation of the corporation for the benefit of all the stockholders until differences are resolved or oppressive conduct ceases; (c) the ordering of an accounting by the majority in control of the corporation for funds alleged to have been misappropriated; (d) an injunction prohibiting continuing acts of oppressive conduct and which may include the reduction of salaries or bonus payments which are unjustified or excessive; (e) affirmative relief including a required declaration of a dividend or a reduction and distribution of capital; (f) affirmative relief requiring the corporation or a majority of its stockholders to purchase the stock of the minority stockholders at a price to be determined according to a specified formula or at a price determined by the court to be a fair and reasonable price; (g) affirmative relief permitting minority stockholders to purchase additional stock under conditions specified by the court; (h) an award of damages to minority stockholders as compensation for injuries suffered as the result of oppressive conduct. *Baker*, 507 P.2d at 395-396(footnotes omitted); *Balvik*, 411 N.W.2d at 389 (quoting *Baker*, 507 P.2d at 395-396).

Viewing the facts alleged in Ms. Cochran's complaint in the light most favorable to Ms. Cochran, and construing the inferences to be drawn from those facts in her favor, we hold Ms. Cochran has stated a claim under section 48-24-301(2)(B).

Holding

In light of the foregoing, we reverse the judgment of the trial court granting Defendants' motion to dismiss for failure to state a claim under Tennessee Code Annotated § 48-24-301(2). We affirm dismissal for failure to state a claim under Tennessee Code Annotated § 61-1-801. We remand this case for determination of the amount of bond to be executed by Ms. Cochran to cover the probable costs of defending the action as required by § 48-24-302, and for further action consistent with this opinion. We additionally note that although the style of this case includes "Reba J. Cochran" and "Larry Vickers," no relief is sought against Reba J. Cochran or Larry Vickers, individually. Costs of this appeal are taxed to the Appellees, L.V.R. & R.C., Inc., Reba J. Cochran and Larry Vickers d/b/a The Home Place.

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DAVID R. FARMER, JUDGE