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CLIENT ALERT

TEXAS SUPREME COURT SIGNIFICANTLY LIMITS THE MINORITY SHAREHOLDER OPPRESSION DOCTRINE

By Mark Wigder, Gray Reed & McGraw, P.C.

In *Ritchie v. Rupe* No. 11 – 0447 (June 20, 2014), the Texas Supreme Court, over a vigorous dissent, delivered a fatal blow to the Texas common-law cause of action for minority shareholder oppression, which had been a powerful weapon in the hands of minority shareholders attacking alleged misconduct on the part of closely held corporations and the principals controlling such corporations. The Court left standing the minority shareholder oppression cause of action only in the context of the statutory remedy of a rehabilitative receivership pursuant to former Article 7.05 of the Texas Business Corporations Act and its successor Section 11. 404 of the Texas Business Organizations Code ("TBOC"). However, because the remedy of a rehabilitative receivership is extremely harsh, the Court developed a stringent definition of oppression by, among other things, incorporating the business judgment rule.

Background

In this case, a minority shareholder in a closely held corporation alleged that the corporation's other shareholders, who were also on the board of directors, engaged in "oppressive" conduct and breached their fiduciary duties by, among other things, offering to buy her shares in the corporation for less than fair value and refusing to meet with prospective outside buyers. The defendants had conferred with an outside attorney with securities expertise and contended at trial that their refusal to meet with the minority shareholder's investment banker and prospective purchasers was based, in part, on such counsel's concerns about potential liability under applicable securities laws. The trial court found such conduct to be "oppressive" and ordered the corporation to purchase the shares of the minority shareholder for $7.3 million. In so doing, the trial court considered both a "fair dealing" test and a "reasonable expectation" test. The Dallas Court of Appeals, applying the law of minority shareholder oppression then being applied by Texas appellate courts, agreed that the directors' refusal to meet with prospective purchasers was "oppressive" as matter of law and upheld the buy-out order but reversed as to the $7.3 million purchase price and remanded the case to the trial court for a new determination of the shares' fair value.

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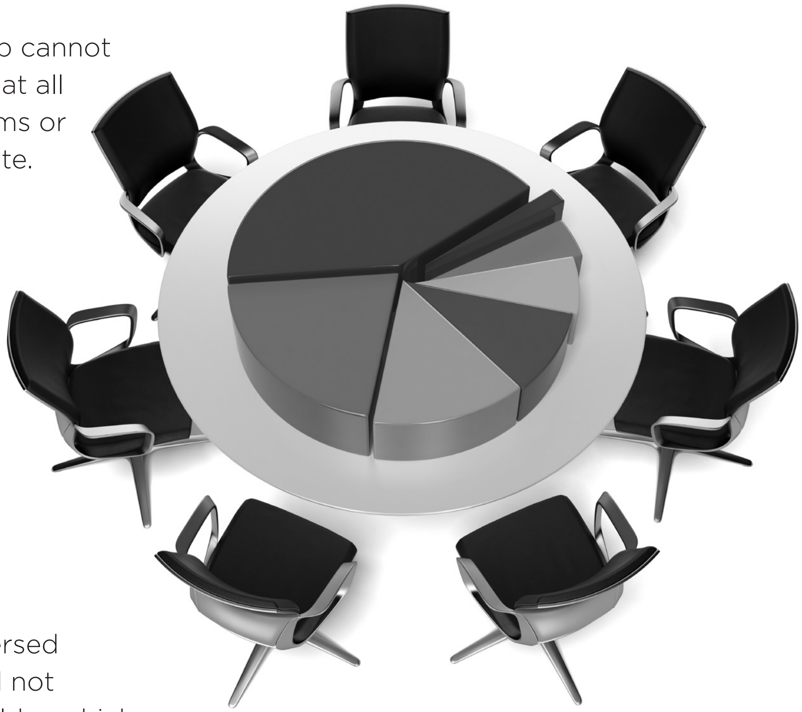
Texas Supreme Court Opinion in *Ritchie*

The Court in declining to recognize a new common-law cause of action for minority shareholder oppression in closely held corporations concluded, among other things, that other adequate remedies exist. These remedies include (i) corporations declaring themselves to be "close corporations," which allows them to take advantage of TBOC provisions dedicated to the special needs of such corporations, (ii) shareholders entering into a shareholders' agreement to govern their respective rights and obligations, and (iii) shareholders pursuing various existing common-law causes of action to address alleged misconduct by corporate directors and officers, including breach of fiduciary duty.

The Court also reasoned that in deciding whether to recognize a new common-law cause of action, consideration needs to be given to whether the new duty would provide clear standards that would deter the undesirable conduct without deterring desirable conduct or unduly restricting freedom. The Court noted that the applicable common-law standards for oppression have been heavily criticized for their vagueness and lack of predictability. The Court cited commentators who expressed concerns presented to counsel advising corporations and their directors and officers by the vague standards for minority shareholder oppression articulated by the courts because it was difficult for such practitioners to predict how a court would rule in any particular case.

While the Court reversed the Dallas Court of Appeals on the minority shareholder oppression issue, the Court remanded the case to the Dallas Court of Appeals because its ruling was based solely on the oppression claim and did not address Rupe's claim for breach of fiduciary duty.

So what is left of the minority shareholder oppression doctrine? The Court held that a claim for shareholder oppression is available only under Section 11.404 of TBOC and that the only remedy available under that statute is a rehabilitative receivership. Moreover, the Court adopted more onerous standards for "oppressive" conduct than the "fair dealing" and "reasonable expectations" tests previously used by the lower Texas courts. Under the new standard, oppression occurs only if a corporation's controlling shareholders, directors or officers "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 harm to the corporation." The Court concluded that the refusal to meet with potential purchasers did not constitute "oppressive" action.



The Court also held that a rehabilitative receivership cannot be appointed unless a trial court has determined that all other lesser available remedies based on other claims or other provisions of the TBOC would not be adequate.

Ritchie is Applied

On June 27, 2014, the Court, citing *Ritchie v. Rupe*, reversed the Dallas Court of Appeals decision in *Cardiac Perfusion Services, Inc. v. Hughes*, which had relied on the minority shareholder oppression doctrine in ordering a buyout of shares of a minority shareholder at a purchase price based on fair market value.

On the same day, the Court declined to review the Dallas Court of Appeals decision in *Shagrithaya v. Argo* in which the Dallas Court of Appeals had reversed the trial court in holding that Argo and its CEO had not oppressed or caused harm to Argo's other shareholder which held a minority position. The trial court had ordered the issuance of an $85 million dividend based, in part, on the minority shareholder's claim of oppression.

Our Take Away on *Ritchie*

The refusal of the Court to recognize a common-law course of action for minority shareholder oppression is significant because it removes from minority shareholders a powerful remedy against controlling shareholders, directors and officers of Texas corporations. However, *Ritchie* should not be viewed as a license for controlling shareholders, directors and officers to run roughshod over minority shareholders as minority shareholders maintain existing effective causes of action under Texas law to address misconduct by them, including claims for breach of fiduciary duty.

In addition, as pointed out by the Court, minority shareholders should protect themselves at the outset by negotiating "shareholder agreements that contain buy-sell, first refusal, or redemption provisions that reflect their mutual expectations of agreements."

Finally, while the Court imposed stringent standards on the remedy of a rehabilitative receivership, *Ritchie* should cause corporate counsel to give consideration as to whether minority shareholders will now seek to use the remedy of a rehabilitative receivership and to keep these standards in mind in structuring and documenting transactions, particularly those involving minority shareholders.

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