



Protecting Minority Shareholders After The Death of “Shareholder Oppression”



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Three shareholders go into business with the best intentions—they will work hard, treat each other fairly, and divide the profits. But a few years into the venture, disputes arise, and the odd-man-out believes he is being treated unfairly by the other two shareholders. Until last summer, the disgruntled shareholder might consider filing a claim for “minority shareholder oppression,” but the Texas Supreme Court has now severely limited that ability, and Texas shareholders will have to look elsewhere for relief.

The Rise and Fall of Shareholder Oppression

Texas appellate courts first recognized “shareholder oppression” as a cause of action in 1988, and as the doctrine evolved, it provided relief from acts of “oppression” by majority shareholders, particularly in closely-held corporations. Oppression could include actions by the majority that were “burdensome, harsh, or wrongful” or that defeated the minority shareholder’s “reasonable expectations” in joining the venture. Over time, shareholder oppression became a powerful tool for minority shareholders, allowing them to challenge the majority’s business decisions through litigation when they could not prevail in a shareholder vote. And under the nebulous standards by which oppression was judged, it was very difficult for a majority shareholder to predict whether she was acting within her rights as the majority or was engaging in oppressive conduct.

In June 2014, however, the Texas Supreme Court ruled in *Ritchie v. Rupe*¹ that there is no common-law cause of action for shareholder oppression in Texas and that the statute many had relied on to support extensive equitable remedies for oppressive conduct would, in most cases, not provide relief.

The Court first held that lower courts had misinterpreted both the meaning of “oppression” and the relief available under Section 11.404 of the Texas Business Organizations Code, which authorizes appointment of a receiver to rehabilitate a domestic entity under certain circumstances, including where a shareholder establishes “that the acts of the directors or those in control of the corporation are illegal, oppressive or fraudulent.” The Court concluded that:

[A] corporation’s directors or managers engage in “oppressive” actions under [the statute] 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.*

The Court expressly rejected the holding of several lower-court cases that the statute authorizes Texas courts to invoke their “general equity power” to craft appropriate equitable relief. The Court found the one and only remedy authorized under the statute was receivership.

The Court then considered whether it should recognize a common-law cause of action for shareholder oppression. After examining the risks and benefits of adopting this new cause of action, the Court determined it would not recognize such a claim. In short, the Court held that existing causes of action were sufficient to remedy most, though admittedly not all, of the concerns to which the “oppression” claim was directed. The Court also repeatedly emphasized that “shareholders may also prevent and resolve common disputes by entering into a shareholders’ agreement to govern their respective rights and obligations.”

Remaining Remedies for Dissatisfied Shareholders

In declining to create a common-law cause of action for shareholder oppression, the *Ritchie* Court relied in part on “the extensive statutory, contractual, and common-law protections that already exist under Texas law.” These claims will now be the toolkit for dissatisfied shareholders.

a. Access to books and records

Those alleging shareholder oppression often complain about the denial of access to the corporation's books and records. But Chapter 21 of the Texas Business Organizations Code protects a corporate shareholder's right to examine corporate records and provides penalties for violations of that right.

b. Derivative action for breach of duty to the entity

The *Ritchie* Court also suggested that derivative actions for breach of fiduciary duty could provide a potential avenue for relief for complaining shareholders if those in control of the company are making decisions that benefit herself at the expense of the company. But the majority shareholder/director generally owes fiduciary duties to the corporation, not to the individual shareholder. So the shareholder must bring any such claim as a derivative claim for the benefit of the corporation. If the alleged act of oppression harms the minority shareholder, but benefits the corporation, a derivative claim will likely not be available.

c. Breach of fiduciary duty to individual arising from confidential relationship

In some circumstances, a minority shareholder can bring a direct claim for breach of fiduciary duty, but only if the majority shareholder owes a fiduciary duty to the minority. The Texas Supreme Court has never recognized a formal fiduciary duty between majority and minority shareholders and expressly declined to do so in *Ritchie*. Texas does, however, recognize informal fiduciary duties in certain cases where a personal relationship of trust and confidence existed prior to the business relationship.

d. Statutory action for receivership

As discussed above, the Texas Business Organizations Code allows minority shareholders to petition courts to appoint a receiver to rehabilitate a corporation where the shareholder establishes "that the actions of the governing persons of the entity are illegal, oppressive, or fraudulent." By limiting the definition of "oppressive" acts to those that create a serious risk of harm to the corporation, the *Ritchie* Court has clarified that minority shareholders have no recourse under the statute for harm they suffer individually.

e. Breach of contract

Minority shareholders may have contractual rights that entitle them to certain voting rights, employment terms, or dividends. Where such contractual rights exist, the minority can enforce those rights through a breach of contract claim. But often there is no express written or oral contract. In such cases, minority shareholders may argue their "reasonable expectations" in joining the venture or the course of dealing between the parties somehow gave rise to an implied contract. A contract can be implied where its terms arise from the acts and conduct of the parties. But the parties must assent to the same thing in the same sense at the same time, and the alleged agreement must contain all material terms.

f. Fraud

Minority shareholders may also be able to make a claim for fraud if they can demonstrate the statements at issue were false when made. The minority must also demonstrate that the representation caused him an injury or that he relied on the representation to his detriment. This can be difficult if the minority shareholder would not have had the ability to improve his situation even had he been given complete information because, for example, he would still have been outvoted.

g. Unjust Enrichment and Quantum Meruit

Where a minority shareholder has contributed valuable goods or services to the enterprise and has not been compensated, he may recover under the theories of unjust enrichment or quantum meruit. But these theories only allow recovery for the value of the goods or services, not for unpaid dividends or the value of the minority shareholder's stock.

Organizational Planning and Shareholder Agreements Are More Important Than Ever

The Court in *Ritchie* made clear that it would not rescue minority shareholders from bad situations when they failed to protect themselves. It therefore encouraged shareholders to set the rules of their relationships at the outset and to put in place enforceable agreements to ensure their expectations are met. These agreements could include employment agreements, buy-sell agreements, dividend policies, and limitations on the powers of the majority.

Situations that often give rise to shareholder disputes and that should, therefore, be addressed in the organizational documents, if possible, are (1) death of a shareholder; (2) divorce of a shareholder; (3) employment disputes; (4) disputes over dividend policy; and (5) the desire of one shareholder to cash out. In the absence of a common-law cause of action for shareholder oppression, having agreements on these issues will become more important than ever.

Conclusion

The Texas Supreme Court's decision in *Ritchie v. Rupe* altered the landscape of Texas law governing disputes between shareholders in closely held companies. In declining to recognize a common-law cause of action for shareholder oppression, the Court acknowledged there may be a "gap" in the protection of minority shareholders for conduct that harms an individual shareholder but does not harm the corporation. Where the majority has truly abused the corporation, committed fraud against the minority, or breached contractual obligations, Texas law already provides vehicles for addressing those wrongs. But where the minority is simply dissatisfied with the majority's business decisions or believes his or her "expectations" have not been met, it will now be more difficult to frame a viable cause of action under Texas law. Unless the Texas legislature steps in to impose statutory standards and remedies, the Court left it to the shareholders to protect themselves by establishing the ground rules of their relationship through appropriate agreements. ■