

TEXAS TURNS A CORNER: RESOLVING SHAREHOLDER DISPUTES IN
CLOSELY HELD BUSINESSES AFTER
RITCHIE V. RUPE

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I.	The History of Shareholder Disputes in Texas	341
	A. Cases Before 1988.....	341
	1. Roots of the Controversy	341
	2. <i>Patton v. Nicholas</i>	342
	B. Business Corporations Act.....	344
	C. Duties Owed By Directors, Officers, and Shareholders	349
II.	Shareholder Oppression Comes to Texas	351
	A. <i>Davis v. Sheerin</i> —Defining Oppression and Creating a Remedy.....	352
	B. Developing the Doctrine	354
	1. <i>Willis v. Bydalek</i>	354
	2. <i>Allchin v. Chemic</i>	356
	3. <i>Cotten v. Weatherford Bancshares</i>	357
	4. <i>Redmon v. Griffith</i>	360
	5. <i>Gibney v. Culver</i>	362
	6. Federal Cases	363
	C. Examining the Definitions	366
	1. “Fair Dealing”	367
	2. “Reasonable Expectations”	368
III.	The <i>Ritchie</i> Trilogy in the Dallas Court of Appeals	370
	A. <i>Ritchie v. Rupe</i>	370
	B. <i>ARGO Data Resources v. Shagrithaya</i>	372

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	C. <i>Cardiac Perfusion Services v. Hughes</i>	374
	D. Impact on Cases in Other Courts.....	375
IV.	The Texas Supreme Court Charts Its Own Course.....	378
	A. <i>Ritchie v. Rupe</i>	378
	1. Oppressive Actions Under the Receivership Statute	381
	2. Shareholder Oppression Under Texas Common Law	382
	3. The <i>Ritchie</i> Dissent.....	384
	B. Completing the Trilogy	385
V.	Shareholder Disputes in Other States	386
VI.	Prospects for the Future	389
	A. Causes of Action Available to Dissatisfied Shareholders	391
	1. Access to Books and Records.....	391
	2. Derivative Action for Breach of Duty to the Entity.....	391
	3. Breach of Fiduciary Duty to Individual Arising From Confidential Relationship.....	395
	4. Statutory Action for Receivership or Liquidation	397
	5. Breach of Contract	398
	6. Fraud	400
	7. Unjust Enrichment and Quantum Meruit.....	403
	B. Organizational Planning and Shareholder Agreements Are More Important Than Ever.....	405
	1. Shareholder Agreements or Other Written Contracts	405
	2. Organizing as a Close Corporation	408
	C. Legislative Action	410
VII.	Conclusion	411

Although several Texas courts had recognized “shareholder oppression” as a cause of action potentially justifying equitable relief such as mandatory buy-outs or dividend orders for minority shareholders in closely held corporations, the Texas Supreme Court had never directly addressed the

claim until 2014. That changed abruptly in June 2014 when the Court in *Ritchie v. Rupe* refused to recognize a common-law claim for shareholder oppression and held that the statutory provision authorizing appointment of a rehabilitative receiver to remedy “oppressive” conduct by those in control of a corporation does not authorize any other remedy.¹ The *Ritchie* opinion prompted immediate reactions by parties and commentators, ranging from sighs of relief to dismay and condemnation. There is widespread agreement, however, that *Ritchie* will significantly impact the legal landscape for disputes between minority shareholders and those in control of closely held companies in Texas.

This article will review the history of shareholder disputes in Texas, including the development of the shareholder oppression doctrine, and assess the Texas Supreme Court’s decision that alternative causes of action can adequately protect the interests served by the doctrine without imposing untenable duties and obligations on majority shareholders or others exercising decision-making authority in closely held corporations.

I. THE HISTORY OF SHAREHOLDER DISPUTES IN TEXAS

A. *Cases Before 1988*

1. Roots of the Controversy

Shareholder complaints concerning management of closely held corporations are hardly new. As early as 1889, the Texas Supreme Court in *Cates. v. Sparkman* held that a suit by an individual stockholder “to control or interfere in the management of the corporate or internal affairs of an incorporated company” could be maintained only for “[action or] threatened action of such board or officers which is beyond the power conferred by its charter,—or such fraudulent transaction completed, [or] contemplated among themselves, or with others, as will result in serious injury to the stockholders suing.”² Even in such cases, the Court held that such claims must be brought by the corporation or (in certain circumstances) by a shareholder “suing representatively.”³ The Court affirmed dismissal of the shareholder’s suit in that case for failure to allege conduct “characterized by

¹ 443 S.W.3d. 856, 877 (Tex. 2014).

² 11 S.W. 846, 848 (Tex. 1889).

³ *Id.* at 848–49.

ultra vires, fraudulent, and injurious practices, abuse of power, and oppression on the part of the company or its controlling agency clearly subversive of the rights of the minority, or of a shareholder, and which, without [judicial] interference, would leave the latter remediless.”⁴

In the 20th century, the shareholder-derivative action acknowledged in *Cates* became a common vehicle for disgruntled shareholders to challenge actions by corporate directors and officers.⁵ Indeed, the Texas Supreme Court repeatedly observed that generally, “the cause of action for injury to the property of a corporation, or the impairment or destruction of its business, is vested in the corporation, as distinguished from its stockholders, even though it may result indirectly in loss of earnings to the stockholders.”⁶ One principle underlying the derivative action is that corporate directors and officers, or others in control of the company, owe strict fiduciary duties to the corporation.⁷

On the other hand, the Court acknowledged that stockholders could sue directly “to restrain, or recover damages for, wrongful acts” that are “violations of duties arising from contracts or otherwise and owing directly to the injured stockholders.”⁸ Determining whether claims by shareholders were correctly brought as “direct” or “derivative” claims, however, has proved difficult over the years. Particularly troublesome is determining whether, and under what circumstances, the directors and officers, or majority shareholders, of a closely held corporation owe any common-law duties directly to individual shareholders.

2. *Patton v. Nicholas*

In 1955, the Texas Supreme Court acknowledged in *Patton v. Nicholas* that “general domination and control of the board of directors” by a majority shareholder is not wrongful, and may be expected.⁹ In analyzing

⁴ *Id.* at 849.

⁵ See *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 547–48 (1949) (describing historical development of derivative action); *Barthold v. Thomas*, 210 S.W. 506, 507 (Tex. 1919).

⁶ *Massachusetts v. Davis*, 168 S.W.2d 216, 221 (Tex. 1942); see also *Stinnett v. Paramount-Famous Lasky Corp.*, 37 S.W.2d 145, 149 (Tex. Comm’n App. 1931, holding approved).

⁷ See *Int’l Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 576–77 (Tex. 1963); *Paddock v. Siemoneit*, 218 S.W.2d 428, 431 (Tex. 1949); *Tenison v. Patton*, 67 S.W. 92, 94 (Tex. 1902).

⁸ *Stinnett*, 37 S.W.2d at 149; see also *Davis*, 168 S.W.2d at 222.

⁹ 279 S.W.2d 848, 853 (Tex. 1955).

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 343

the conduct of the defendant shareholder at issue, the Court noted: “[b]eing the founder of the business, president, owner of a clear majority of the stock and the only substantial stockholder on a board composed largely of employees, he could hardly avoid imposing his personal views on the other members, whatever his intentions.”¹⁰ “But,” the Court held, “the finding of his control of the board for the malicious purpose of, and with the actual result of, preventing dividends and otherwise lowering the value (. . . in the market place) of the stock of the [minority shareholders], is something else.”¹¹

The “malicious purpose” in *Patton* was established by events beginning before the corporation was formed and continuing thereafter.¹² The corporation was created to comply with a contractual settlement of a profit-distribution dispute between members of a partnership.¹³ Shortly after incorporation, the majority shareholder declared that “no dividends would be paid so long as the respondents were stockholders,” and that “he would not buy the stock of respondents for even a small fraction of its value or sell his own at any price.”¹⁴ The Court sustained the finding of malicious suppression of dividends, “coupling all the circumstances indicating the [majority shareholder’s] intent to eliminate the [minority] from every connection with the business, and at an unfair sacrifice on their part, with the fact that no dividends were paid.”¹⁵

The *Patton* Court reversed the lower court’s order liquidating the corporation through a receivership, and remanded to the trial court for determination of an appropriate dividend and entry of a mandatory injunction “tailoring the remedy to fit the particular case.”¹⁶ The Court affirmed the lower court’s denial of damages based on past “deprivation of dividends.”¹⁷ On remand, the trial court in *Patton* appointed a Master in Chancery, who recommended a dividend based on the report of a

¹⁰ *Id.*

¹¹ *Id.*

¹² *See id.* at 850.

¹³ *See id.*

¹⁴ *Id.* at 851–52.

¹⁵ *Id.* at 854.

¹⁶ *Id.* at 857.

¹⁷ *Id.* at 858; *see also* Faour v. Faour, 789 S.W.2d 620, 622 (Tex. App.—Texarkana 1990, writ denied) (following *Patton*, holding shareholder cannot claim damages “for dividends not paid in the past”).

disinterested CPA, and the court entered judgment mandating a dividend in that amount.¹⁸

The next year, *Patton* was cited for the following proposition:

[Although it is generally] the corporation and not the stockholders which must redress wrongs which weaken corporate values. . . , where a majority stockholder has abused its discretion and has maliciously suppressed the payment of dividends, a stockholder may assert a cause of action for damages and may compel the declaration of dividends.¹⁹

No general rule was necessary in that case, however, where the plaintiff was a former stockholder suing to enforce the directors' *contractual* obligation "to declare and pay each year . . . all net earnings of the corporation" during the period he retained his stock.²⁰

Subsequent cases—including *Davis v. Sheerin*, discussed in Part II, *infra*—have cited *Patton* for the broader proposition that "courts have equitable powers to fashion appropriate remedies,"²¹ including liquidation, buy-outs, or "less harsh remedies" in the absence of statutory authority,²² "where the majority shareholders have engaged in oppressive conduct."²³

B. Business Corporations Act

Texas courts recognizing "shareholder oppression" often sought statutory authority for the cause of action. Article 7.05 of the Texas Business Corporations Act, entitled "Appointment of a Receiver to Rehabilitate Corporation," provides:

A. A receiver may be appointed for the assets and business of a corporation by the district court . . . whenever

¹⁸*Patton v. Nicholas*, 302 S.W.2d 441, 443 (Tex. Civ. App.—Waco 1957, writ ref'd n.r.e.).

¹⁹*Morrison v. St. Anthony Hotel*, 295 S.W.2d 246, 250 (Tex. Civ. App.—San Antonio 1956, writ ref'd n.r.e.) (citing *Patton*, 302 S.W.2d at 443).

²⁰*Id.*

²¹754 S.W.2d 375, 380 (Tex. App.—Houston [1st Dist.] 1988, writ denied) (citing *Masinter v. Webco Co.*, 262 S.E.2d 433, 439–40 (W. Va. 1980)). As discussed in Part IV, the Texas Supreme Court in *Ritchie* rejected this reading of *Patton*.

²²*Id.*

²³*Id.*

circumstances exist deemed by the court to require the appointment of a receiver to conserve the assets and business of the corporation and to avoid damage to parties at interest, *but only if* all other requirements of law are complied with and if *all other remedies* available either at law or in equity, including the appointment of a receiver for specific assets of the corporation, *are determined by the court to be inadequate*, and only in the following instances:

(1) In an action by a shareholder when it is established:

. . . .

(c) That the acts of the directors or those in control of the corporation are illegal, *oppressive* or fraudulent²⁴

The legislature enacted Article 7.05 in 1955 and amended it in 1961.²⁵ The *Patton* Court noted that the “new and elaborate ‘Texas Business Corporations Act’” was not yet in effect at the time of its decision,²⁶ but it did rely on an earlier statute authorizing receivership under similar circumstances.²⁷

Authority for a court-appointed receiver has been codified as Texas Business Organizations Code § 11.404, effective January 1, 2006.²⁸ The wording of § 11.404 generally incorporates the provisions of Article 7.05, but expands it to include all domestic entities under § 11.402(b).²⁹ The new provision reads:

(a) Subject to Subsection (b), a court that has jurisdiction over the property and business of a domestic entity under

²⁴TEXAS BUS. CORP. ACT, 54th Leg., R.S., ch. 64, art. 7.05(A)(1)(c), 1955 Tex. Gen. Laws 290, 290–291 (emphasis added).

²⁵Texas Bus. Corp. Act, 54th Leg., R.S., ch. 64, art. 7.05; Act of Jan. 11, 1955, 54th Leg., R.S., ch. 64, 1955 Tex. Gen. Laws 290, 290–91, *amended by* Act of May 17, 1961, 57th Leg., R.S., ch. 169, 1961 Tex. Gen. Laws 319, 319.

²⁶*Patton v. Nicholas*, 279 S.W.2d 848, 854 (Tex. 1955).

²⁷*Id.* at 856–57 (citing Tex. Rev. Civ. Stat. Ann. art. 2293).

²⁸TEX. BUS. ORGS. CODE ANN. § 11.404 (West 2012).

²⁹*See id.*

Section 11.402(b) *may appoint a receiver* for the entity's property and business if:

(1) in an action by an owner or member of the domestic entity, it is established that:

....

(C) the actions of the governing persons of the entity are illegal, *oppressive*, or fraudulent

....

(b) A court may appoint a receiver under Subsection (a) only if:

(1) circumstances exist that are considered by the court to necessitate the appointment of a receiver to conserve the property and business of the domestic entity and avoid damage to interested parties;

(2) all other requirements of law are complied with; and

(3) *the court determines that all other available legal and equitable remedies, including the appointment of a receiver for specific property of the domestic entity under Section 11.402, are inadequate.*³⁰

These statutes provide little guidance for courts and business owners because the term “oppressive” is not defined. Courts interpreting these provisions, however, have generally been hesitant to impose the harsh remedy of a receiver and have held that dissatisfaction with management's decisions would not justify relief under the statute.³¹

In *Texarkana College Bowl, Inc. v. Phillips*, for example, a minority shareholder claimed that the assets of the corporation were misapplied and wasted by the people controlling the corporation and that this conduct was

³⁰*Id.* § 11.404 (a)(1)(C), (b)(1)–(3) (emphasis added).

³¹*Texarkana College Bowl, Inc. v. Phillips*, 408 S.W.2d 537, 538–39 (Tex. Civ. App.—Texarkana 1966, no writ).

illegal, oppressive, or fraudulent.³² Specifically, he alleged that by failing to reopen and operate the business, several losses would occur, leading to abandonment of the purpose and function of the corporation.³³ The court held the Business Corporations Act places the management of a business in the hands of the board of directors and that dissatisfaction with corporate management is not grounds to appoint a receiver under Article 7.05.³⁴

In *Balias v. Balias, Inc.*, Demetrios Balias requested an appointment of a receiver due to alleged illegal, oppressive, or fraudulent acts, claiming he and his brother had a fifty-fifty agreement for ownership, management, and division of profit, although no formal shareholder agreement had been executed to evidence that agreement.³⁵ He claimed his brother had: (1) ousted Demetrios from management; (2) removed corporate funds and changed accounts; (3) claimed 100% ownership on federal tax filings; and (4) changed the name of the corporation and listed himself as sole shareholder through a unilateral amendment to the articles of incorporation.³⁶ On appeal, the court held that the trial court did not abuse its discretion in denying Demetrios's claim that his brother's acts were "oppressive" under Article 7.05(A)(1)(c).³⁷ The court reasoned that Demetrios had failed to establish an enforceable provision governing the shareholders, failed to demonstrate any kind of arrangement that made his brother's actions improper, and failed to prove he had no other adequate remedies available.³⁸ Further, "considerable flexibility [is allowed] in close corporation management," and the Close Corporation Law did not require any of the actions Demetrios claimed his brother failed to do.³⁹

Article 7.05, by its terms and the courts' interpretations, also requires a showing that no other remedies are adequate. The Austin Court of Appeals in *Fortenberry v. Cavanaugh* said that the "existence of serious disagreements . . . does not inexorably lead to the appointment of a

³² *Id.*

³³ *Id.* at 539.

³⁴ *Id.*

³⁵ 748 S.W.2d 253, 256 (Tex. App.—Houston [14th Dist.] 1988, writ denied).

³⁶ *Id.*

³⁷ *Id.* at 257.

³⁸ *Id.*

³⁹ *Id.*

receiver.”⁴⁰ The Cavanaugh’s claimed that a receiver was appropriate based on three subparts of Article 7.05, including illegal and oppressive conduct, and that the alternative remedy proposed by Fortenberry, the lawsuit itself, was inadequate.⁴¹ The court disagreed, explaining, “[t]hat lawsuits are not expeditious and inexpensive does not mean they are an inadequate remedy—or more importantly, that they should not be employed before the harsh remedy of receivership is triggered.”⁴²

Courts have construed Article 7.05 as specifically intended to rehabilitate a corporation and not authorizing appointment of a receiver to liquidate assets.⁴³ In an interlocutory appeal from a trial court’s order to liquidate a corporation, the court of appeals in *Mueller v. Beamalloy* considered whether Article 7.05 authorized liquidation.⁴⁴ One argument asserted by the appellees was that appointment of a receiver was appropriate under Article 7.05(A)(3).⁴⁵ Article 7.05’s only stated remedy is rehabilitation of the corporation, and no provision contained within it expressly or impliedly authorizes the authority to appoint a receiver to liquidate a corporation.⁴⁶ The court explained:

While the legislature included authority “under the usages of the court of equity” in enacting Article 7.05 for *rehabilitative* receiverships, the legislature did not authorize trial courts to exercise their equitable powers in enacting Article 7.06 for *liquidating* receiverships. . . . While simultaneously omitting equitable powers in the authority granted under Article 7.06, the legislature

⁴⁰No. 03-04-00816-CV, 2005 WL 1412103, at *3 (Tex. App.—Austin June 16, 2005, no pet.) (mem. op., not designated for publication).

⁴¹*Id.*

⁴²*Id.*; see also *Texarkana College Bowl, Inc. v. Phillips*, 408 S.W.2d 537, 540 (Tex. Civ. App.—Texarkana 1966, no writ) (finding that receivership is prohibited by Article 7.05 of the Business Corporation Act unless it is shown that all other remedies are inadequate to conserve the corporation’s assets).

⁴³See *Mueller v. Beamalloy, Inc.*, 994 S.W.2d 855, 861 (Tex. App.—Houston [1st Dist.] 1999, no pet.).

⁴⁴*Id.* at 857, 860.

⁴⁵*Id.* at 860–61.

⁴⁶*Id.* at 861.

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 349

expressed its intent to limit equitable authority to rehabilitation.⁴⁷

Accordingly, it appears that the receivership statute, standing alone, provided little solace for a dissatisfied minority shareholder. But, as discussed below, some courts latched onto these statutory provisions as a stepping-off point for the creation of broader equitable powers to remedy conduct deemed “oppressive.”

C. Duties Owed By Directors, Officers, and Shareholders

The rise and fall of “shareholder oppression” as a cause of action in Texas discussed in Parts II–IV should be viewed in the context of other aspects of Texas law governing business relationships. Foremost among these is the reluctance of Texas courts to impose fiduciary duties or similar obligations except in certain narrowly defined circumstances.

In 1983, the Texas Supreme Court rejected what it called a “novel theory of law enunciated only by California courts”—a “covenant of ‘good faith and fair dealing’” implied in every contract.⁴⁸ The Court declined to adopt such an implied covenant, however “laudatory sounding” it might be, because it would “let each case be decided upon what might seem ‘fair and in good faith’” by a jury.⁴⁹ Although in the intervening years most other American jurisdictions adopted some form of the doctrine, Texas has steadfastly refused to impose a duty of good faith and fair dealing on every contract.⁵⁰ Such a covenant is implied only in contracts arising from special relationships, such as that between a liability insurer and its policyholder.⁵¹

Likewise, Texas has been less willing than other states to impose fiduciary duties, especially in business dealings.⁵² The Texas Supreme Court has repeatedly emphasized its “reluctance to recognize fiduciary

⁴⁷ *Id.*

⁴⁸ *English v. Fischer*, 660 S.W.2d 521, 522 (Tex. 1983).

⁴⁹ *Id.*

⁵⁰ *See* *Crim. Truck & Tractor Co. v. Navistar Int’l Transp. Corp.*, 823 S.W.2d 591, 595 (Tex. 1992); *FDIC v. Coleman*, 795 S.W.2d 706, 709 (Tex. 1990); *City of Midland v. O’Bryant*, 18 S.W.3d 209, 215 (Tex. 2000).

⁵¹ *Arnold v. Nat’l Cnty. Mut. Fire Ins. Co.*, 725 S.W.2d 165, 167 (Tex. 1987).

⁵² *See* *Willis v. Donnelly*, 199 S.W.3d 262, 278 (Tex. 2006); *see also* *Associated Indem. Corp. v. CAT Contracting, Inc.*, 964 S.W.2d 276, 287–88 (Tex. 1998); *Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171, 177 (Tex. 1997).

relationships, especially in the commercial context.”⁵³ Texas law distinguishes between “formal” and “informal” fiduciary relationships.⁵⁴ Formal fiduciary relationships arise as a matter of law from the inherent nature of certain legal arrangements, such as attorney-client, trustee-beneficiary, principal-agent, executor-beneficiaries, corporate officers, and the like.⁵⁵ As noted above, directors and officers owe strict fiduciary duties to act in the best interests of the corporation.⁵⁶ Outside those types of relationships, and as articulated in the pattern jury charge, no fiduciary duty is owed absent proof of a special relationship of trust and confidence separate and apart from the business dealings at issue.⁵⁷

Applying these principles, most Texas courts have specifically refused to find fiduciary duties owed to individual shareholders, either by directors or other shareholders, as a matter of law.⁵⁸ The Texas Supreme Court in *Willis v. Donnelly* reversed a judgment premised on the theory that a majority shareholder owes a fiduciary duty to a minority shareholder, but did not directly address that issue.⁵⁹ Instead, the Court held that no such

⁵³ *Willis*, 199 S.W.3d at 278; see also *Associated Indem. Corp.*, 964 S.W.2d at 287–88; *Schlumberger Tech. Corp.*, 959 S.W.2d at 177.

⁵⁴ *Jones v. Blume*, 196 S.W.3d 440, 447 (Tex. App.—Dallas 2006, pet. denied).

⁵⁵ See, e.g., *Int’l Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 576 (Tex. 1963); *Stephens Cnty. Museum, Inc. v. Swenson*, 517 S.W.2d 257, 260 (Tex. 1974); *Avary v. Bank of Am., N.A.*, 72 S.W.3d 779, 791 (Tex. App.—Dallas 2002, pet. denied).

⁵⁶ See cases cited *supra* note 6. The case law imposes fiduciary duties on corporate directors and officers. The extent to which Texas law restricts the right of *shareholders*, acting in that capacity, to act in their own interests is beyond the scope of this article. This distinction is difficult to draw in closely held companies with two or three shareholders.

⁵⁷ See Comm. on Pattern Jury Charges, State Bar of Tex., *Texas Pattern Jury Charges: Business, Consumer Insurance, and Employment* PJC 104.1 (2014); *Meyer v. Cathey*, 167 S.W.3d 327, 330–31 (Tex. 2005).

⁵⁸ See, e.g., *Pabich v. Kellar*, 71 S.W.3d 500, 504 (Tex. App.—Fort Worth 2002, pet. denied) (“A co-shareholder in a closely held corporation does not as a matter of law owe a fiduciary duty to his co-shareholder.”); *Myer v. Cuevas*, 119 S.W.3d 830, 836 (Tex. App.—San Antonio 2003, no pet.) (“Corporate officers owe fiduciary duties to the corporations they serve. . . . [but not] to individual shareholders unless a contract or special relationship exists between them in addition to the corporate relationship.”); *Hoggett v. Brown*, 971 S.W.2d 472, 488 (Tex. App.—Houston [14th Dist.] 1997, pet. denied); *Redmon v. Griffith*, 202 S.W.3d 225, 237 (Tex. App.—Tyler 2006, pet. denied); *Kaspar v. Thorne*, 755 S.W.2d 151, 155 (Tex. App.—Dallas 1988, no writ) (reversing judgment because trial court erroneously instructed jury that shareholder owed fiduciary duty to co-shareholder as a matter of law).

⁵⁹ *Willis v. Donnelly*, 199 S.W.3d 262, 269 (Tex. 2006).

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 351

duty could arise where the plaintiff “never actually became a shareholder.”⁶⁰ In rejecting other possible bases for imposing a fiduciary duty, the Court reiterated the heavy burden required to impose such a duty.⁶¹ Although, as discussed in Section Part VI.A, it is possible Texas courts would recognize an informal fiduciary duty owed to shareholders in certain situations, such a case would be the exception, rather than the rule.⁶²

A corollary principle of Texas law is that a shareholder has no independent claim for injury to a corporation, including a closely held corporation.⁶³ In *Wingate v. Hajdik*, for example, the Texas Supreme Court held a sole shareholder could not recover for a former shareholder’s misappropriation of corporate assets for personal use.⁶⁴ The appellate court in *Emmett Properties, Inc. v. Halliburton Energy Services, Inc.* explained this principle: “Even though stockholders may sustain indirect losses, *they have no independent right* to bring an action for injuries suffered by the corporation.”⁶⁵ Claims for injury to the corporation or for breach of duties owed to the corporation belong solely to the corporation and may be brought by a shareholder only through a derivative action.⁶⁶

II. SHAREHOLDER OPPRESSION COMES TO TEXAS

As noted above, the Texas receivership statute has referred to “oppressive” conduct by corporate directors and officers since 1955.⁶⁷ In

⁶⁰ *Id.* at 277.

⁶¹ *Id.* at 278.

⁶² See *infra* Part VI.A.

⁶³ *Emmett Props., Inc. v. Halliburton Energy Servs., Inc.*, 167 S.W.3d 365, 371 (Tex. App.—Houston [14th Dist.] 2005, pet. denied).

⁶⁴ 795 S.W.2d 717, 719 (Tex. 1990).

⁶⁵ *Emmett*, 167 S.W.3d at 371; see also *Nauslar v. Coors Brewing Co.*, 170 S.W.3d 242, 250 (Tex. App.—Dallas 2005, no pet.) (applying *Wingate* to partnership, holding that “[a]n individual stakeholder in a legal entity does not have a right to recover personally for harms done to the legal entity”); *Asshauer v. Wells Fargo Foothill*, 263 S.W.3d 468, 472 (Tex. App.—Dallas 2008, pet. denied) (affirming dismissal for lack of standing of claims brought by limited partners against another limited partner, including an alleged “overall plan to suck the final few dollars out of Plaintiffs’ investment, leaving Plaintiffs with nothing but empty husks of Partnerships”).

⁶⁶ *Faour v. Faour*, 789 S.W.2d 620, 622 (Tex. App.—Texarkana 1990, writ denied).

⁶⁷ Act of April 15, 1955, 54th Leg., R.S., ch. 64, art. 7.05(A)(1)(c), 1955 Tex. Gen. Laws 290, 290–91 (expired Jan. 1, 2010).

1988, Texas courts began to connect that statute to the common-law doctrine of shareholder oppression applied by other jurisdictions.⁶⁸

A. *Davis v. Sheerin—Defining Oppression and Creating a Remedy*

The Houston First District Court of Appeals was the first Texas court to expressly recognize a cause of action for shareholder oppression.⁶⁹ Sheerin, a minority shareholder owning a 45% share of the corporation, sued Davis, owner of the remaining 55%, both individually and on behalf of the corporation, alleging oppressive conduct and breaches of fiduciary duties owed to him and to the corporation.⁷⁰ Sheerin and Davis incorporated the business in 1955 and served as directors and officers, along with Davis's wife.⁷¹ Davis conducted the daily management of the corporation; Sheerin, unlike Davis and his wife, was not an employee of the business.⁷² Davis and Sheerin also formed a partnership that contained six pieces of real property.⁷³ After Davis and his wife refused to allow Sheerin to inspect the corporation's books without production of his stock certificate, Sheerin filed suit.⁷⁴ Davis and his wife claimed that Sheerin had gifted his 45% interest to them.⁷⁵

Following a jury trial, the court declared that Sheerin owned 45% of the corporation, the partnership, and the six pieces of real property, and the court issued multiple orders and awards of damages.⁷⁶ Most pertinent to this discussion were: (1) an order that Davis and his wife buy out Sheerin's 45% share of the corporation's stock for its "fair value" determined by the jury, and (2) a mandatory injunction requiring future dividend payments.⁷⁷

The appellate court began its search for a definition of "oppressive conduct" with Article 7.05 of the Texas Business Corporations Act.⁷⁸ It

⁶⁸ *Davis v. Sheerin*, 754 S.W.2d 375, 381 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

⁶⁹ *See id.*

⁷⁰ *Id.* at 377.

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.* 377–78.

⁷⁴ *Id.* at 377.

⁷⁵ *Id.*

⁷⁶ *Id.* at 378.

⁷⁷ *Id.*

⁷⁸ *Id.* at 381.

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 353

noted the Act's failure to define "oppressive" conduct, but instead of discussing the previous Texas cases considering the issue,⁷⁹ the court turned "to decisions of other jurisdictions" to find a meaning.⁸⁰ What it found was "an expansive term that is used to cover a multitude of situations dealing with improper conduct, [for which] a narrow definition would be inappropriate."⁸¹ The court leaned heavily on opinions from states that recognized a fiduciary duty owed as a matter of law to minority shareholders by a corporation's directors, officers, or majority shareholders, including Oregon,⁸² Alaska,⁸³ New Mexico,⁸⁴ and Montana.⁸⁵ Under this approach, oppressive conduct is described using terms like "burdensome, harsh . . . lack of fair dealing . . . violation of fair play."⁸⁶ The court did not address whether the premise of these cases was compatible with Texas law. The court also noted a New York court's limitation of oppression to situations in which the majority's conduct substantially defeats a minority shareholder's objectively reasonable expectations, but the court did not discuss how those expectations might be determined.⁸⁷ Such decisions were left to the court, based on the facts of each case: "Although whether certain acts were performed is a question of law, the determination of whether those acts constitute oppressive conduct is usually a question of law for the court."⁸⁸

Based on its interpretation of *Patton* and Article 7.05, the court in *Davis* concluded that Texas courts have authority, as part of their general equity

⁷⁹ See, e.g., *Balias v. Balias, Inc.*, 748 S.W.2d 253, 256–57 (Tex. App.—Houston [14th Dist.] 1988, writ denied) (trial court properly denied application for "harsh remedy" of receivership where plaintiff sought to enforce informal "arrangement" not memorialized in shareholder agreement or articles of incorporation); *Texarkana College Bowl, Inc. v. Phillips*, 408 S.W.2d 537, 539 (Tex. Civ. App.—Texarkana 1966, no writ) (statute not satisfied by allegations of "dissatisfaction with corporate management").

⁸⁰ *Davis*, 754 S.W.2d at 381.

⁸¹ *Id.*

⁸² *Id.* (citing *Baker v. Commercial Body Builders, Inc.*, 507 P.2d 387, 395–96 (Or. 1973)).

⁸³ *Id.* (citing *Alaska Plastics, Inc. v. Coppock*, 621 P.2d 270, 276 (Alaska 1980)).

⁸⁴ *Id.* (citing *McCauley v. Tom McCauley & Son, Inc.*, 724 P.2d 232, 236 (N.M. Ct. App. 1986)).

⁸⁵ *Id.* (citing *Skierka v. Skierka Bros., Inc.*, 629 P.2d 214, 221 (Mont. 1981)).

⁸⁶ *Id.* at 382.

⁸⁷ *Id.* at 381 (citing *In re Wiedy's Furniture Clearance Ctr. Co.*, 108 A.D.2d 81, 83–84 (N.Y. App. Div. 1985)).

⁸⁸ *Id.* at 380.

power, to decree a buy-out when lesser remedies are not adequate to protect the parties.⁸⁹ Relying on the out-of-state cases discussed above, the court concluded that a buy-out is a common remedy for oppressive conduct and particularly appropriate in closely held corporations.⁹⁰ The court held that the findings of conspiracy, the willful breach of fiduciary duty,⁹¹ and the evidence that Sheerin would have no voice in the corporation in the future were sufficient to constitute oppressive conduct and to justify the buy-out ordered by the trial court.⁹² The court held, however, that the trial court abused its discretion in mandating future dividends.⁹³

B. *Developing the Doctrine*

1. *Willis v. Bydalek*

Davis did not have an immediate impact on Texas law. The First District Court in Houston next considered shareholder oppression over ten years later, in *Willis v. Bydalek*.⁹⁴ Joseph Bydalek and Robert M. Fox formed a corporation to purchase and operate a club.⁹⁵ Fox, the sole officer and director, owned 51% of the shares, while Bydalek owned the remaining 49%.⁹⁶ Each shareholder made an initial loan to the corporation; the Bydaleks' total financial contribution was \$31,000.00.⁹⁷ The shareholders agreed that while Fox would operate as the administrator, the Bydaleks would handle the day-to-day operations.⁹⁸ The Bydaleks expected to work at the club for a long period but did not have an employment agreement.⁹⁹ The day the club opened, Fox died in an auto accident, and his sister,

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ The minority shareholder alleged breach of "fiduciary duties owed to [himself] and the corporation." *Id.* at 377. The jury found a "willful breach of the fiduciary duty" in the officers' use of corporate funds to pay their legal fees, and in their receiving "informal dividends by making profit sharing contributions for their benefit and to the exclusion of [Sheerin]." *Id.* at 382.

⁹² *Id.* at 383.

⁹³ *Id.* at 385.

⁹⁴ 997 S.W.2d 798, 799 (Tex. App.—Houston [1st Dist.] 1999, pet. denied).

⁹⁵ *Id.*

⁹⁶ *Id.* at 800.

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ *Id.*

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 355

Willis, was appointed administrator of his estate.¹⁰⁰ Within months, problems developed in the relationship between Willis and the Bydaleks, which resulted in Willis changing the locks and preventing the Bydaleks from managing the club thereafter.¹⁰¹ The Bydaleks sued for conversion, breach of fiduciary duty, violation of a temporary injunction, civil conspiracy, and shareholder oppression.¹⁰² The jury, having been charged on conversion and wrongful lockout only, found that although there was no conversion, Willis had willfully and maliciously locked out the Bydaleks.¹⁰³ The jury determined the fair value of the shares was \$612.50 and awarded \$180,000 in punitive damages.¹⁰⁴ The court entered judgment for shareholder oppression for the stock value, and remitted the punitive damages to a lesser amount.¹⁰⁵

Willis argued on appeal that *Davis* was improperly decided and, alternatively, that the verdict did not support a finding of shareholder oppression.¹⁰⁶ The court distilled two definitions of oppressive conduct from *Davis*:

1. majority shareholders' conduct that substantially defeats the minority's expectations that, objectively viewed, were both reasonable under the circumstances and central to the minority shareholder's decision to join the venture; or
2. burdensome, harsh, or wrongful conduct; a lack of probity and fair dealing in the company's affairs to the prejudice of some members; or a visible departure from the standards of fair dealing and a violation of fair play on which each shareholder is entitled to rely.¹⁰⁷

The court also noted that caution should be exercised in evaluating what constitutes oppressive conduct; reasonable expectations of the minority

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ *Id.* at 800–01.

¹⁰⁶ *Id.* at 801.

¹⁰⁷ *Id.* at 801 (citing *Davis v. Sheerin*, 754 S.W.2d 375, 381–82 (Tex. App.—Houston [1st Dist.] 1988, writ denied)).

shareholder must be balanced with the corporation's ability to use its business judgment and run efficiently.¹⁰⁸ While sufficient evidence supported the jury's finding of a wrongful lock-out, the court held there was no shareholder oppression when: (1) the only wrong found was the lock-out; (2) neither the club nor Willis had ever made a profit; and (3) the Bydaleks lacked an employment agreement and were therefore employed at will.¹⁰⁹ Having held that no shareholder oppression existed under the given facts, the court declined to address whether *Davis* should be overruled.¹¹⁰

2. *Allchin v. Chemic*

The Houston Fourteenth District Court of Appeals also refused to find that a cause of action for shareholder oppression existed, at least under the circumstances presented in *Allchin v. Chemic, Inc.*¹¹¹

Walter Wadiak initially formed Chemic as the sole shareholder and president in 1983.¹¹² Thirteen years later, Wadiak and his neighbor, Steven Allchin, executed two contracts that resulted in Allchin becoming a shareholder and serving as executive vice-president, chairman of the board, and secretary of Chemic.¹¹³ Allchin paid for part of the stock and had an outstanding balance for the remaining stock; he maintained that he paid for the balance through compensation owed.¹¹⁴ Wadiak and Allchin's relationship became strained, and Allchin gave notice that he would no longer be working at Chemic.¹¹⁵ The termination of Allchin's employment triggered a clause in the Buy-Sell Agreement, which provided that Chemic had "the option to purchase a shareholder's stock if the shareholder died, terminated employment, or effected a stock transfer in another manner."¹¹⁶

¹⁰⁸ *Id.*

¹⁰⁹ *Id.* at 801–02.

¹¹⁰ *See id.* at 802–03 (noting that the court was "not holding that firing an at-will employee who is a minority shareholder can never, under any circumstances, constitute shareholder oppression; we simply hold that under these particular facts, it does not.").

¹¹¹ No. 14-01-00433-CV, 2002 WL 1608616, at *8 (Tex. App.—Houston [14th Dist.] July 18, 2002, no pet.) (not designated for publication).

¹¹² *Id.* at *1.

¹¹³ *Id.*

¹¹⁴ *Id.* at *2.

¹¹⁵ *Id.* at *3.

¹¹⁶ *Id.* at *2–3.

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 357

A suit followed in which the trial court granted a motion for directed verdict against Allchin's shareholder oppression claim.¹¹⁷

On appeal, the court first noted that Allchin claimed ownership to fifty percent of the stock, the stock certificates indicated he owned fifty percent, and he had equal voting rights with Wadiak as provided for under the terms of the sales contract.¹¹⁸ The court questioned whether oppressive action could exist in Texas where the plaintiff and defendant were equal shareholders and neither had "control" over the company.¹¹⁹

But even if the defendant were in control of the company, the court refused to find a valid cause of action for shareholder oppression.¹²⁰ The court found the shareholder oppression claim was based on the following allegations: (1) Allchin did not receive as much training as he expected; (2) Wadiak failed to use his talent and best effort to increase success of the business; (3) Wadiak failed to participate and contribute to business operation and leadership; (4) Wadiak failed to let Allchin be involved in the management of the company; (5) Wadiak used the company for personal gain; (6) Wadiak failed to obtain Allchin's consent to the proposal to purchase Allchin's stock; and (7) Wadiak failed to keep the company accounts in the bank specified in the sales contract.¹²¹ The court found these allegations were mere "disagreements about policy and, as such, [did] not support a claim of shareholder oppression"¹²²

3. *Cotten v. Weatherford Bancshares*

The Fort Worth Court of Appeals considered whether a claim of shareholder oppression was viable in the context of a bank holding company with "common" and "preferred" shareholders.¹²³ James Cotten's family had an ownership interest in the First National Bank of Weatherford for over one hundred years.¹²⁴ During the seventies, the bank formed a

¹¹⁷ *Id.* at *4.

¹¹⁸ *Id.* at *7.

¹¹⁹ *See id.*

¹²⁰ *Id.* at *8.

¹²¹ *Id.* at *9.

¹²² *Id.*

¹²³ *See Cotten v. Weatherford Bancshares, Inc.*, 187 S.W.3d 687, 694 (Tex. App.—Fort Worth 2006, pet. denied).

¹²⁴ *Id.*

holding company, Weatherford Bancshares, Inc. (WBI).¹²⁵ In exchange for the ownership interest in the bank, the shareholders were given preferred stock in WBI.¹²⁶ Over time, a multi-tiered holding company developed: Parker County Bancshares, Inc. owned all of First Parker Bancshares, Inc., which owned 99.84% of WBI, which owned all of First Weatherford Bancshares, Inc., which held 99.3% of the actual bank.¹²⁷ In the early nineties, Joe Sharp acquired the majority of the common stock of Parker County Bancshares, and this purchase automatically gave him a controlling interest in the other holding companies and the bank.¹²⁸ Sharp intended to obtain complete ownership, but Cotten and his family were not amenable to selling their shares.¹²⁹ Sharp began purchasing shares from other people for between \$114–117, and he offered Cotten \$117.¹³⁰ After Cotten's refusal, Sharp initiated an involuntary merger that would require Cotten to sell.¹³¹ Cotten sued for an appraisal, which determined the value of the shares to be \$250, after which Sharp acquired the remainder of the stock of Parker County Bancshares.¹³² Cotten and his family, however, retained preferred stock in WBI and expected dividends to be paid.¹³³

After no dividends were issued, Cotten, on behalf of himself and other preferred shareholders, sought explanation from Sharp regarding the non-payment of dividends from WBI.¹³⁴ Eventually, Sharp and Stratham, who were WBI's only directors, told Cotten and his family that their preferred stock was being redeemed.¹³⁵ Cotten objected that the redemption could only occur by lot or pro rata as specified in the articles of incorporation, and accordingly, the redemption was not effective.¹³⁶ After the attempted redemption, Cotten discovered a discrepancy in the bank's public records; the records showed an unexplained \$16,000 decrease in the stock of the

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ *Id.*

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ *Id.* at 705.

¹³¹ *Id.*

¹³² *Id.* at 705–06.

¹³³ *Id.* at 694–95, 706.

¹³⁴ *Id.* at 695.

¹³⁵ *Id.*

¹³⁶ *Id.* at 695, 706.

bank.¹³⁷ Only some of the requested records were produced after Cotten's request, and when he demanded the rest of the records, Sharp and Stratham informed him that his preferred shares had been chosen in a random drawing for redemption.¹³⁸

Cotten filed a declaratory action against: (1) WBI seeking to enforce his right to inspect records and for wrongful redemption of his preferred shares; and (2) Sharp and his daughter for fraud, breach of fiduciary duty, shareholder oppression, and conspiracy.¹³⁹ After the court disposed of the majority of claims by granting a no-evidence partial summary judgment for Sharp and Stratham and by directing verdicts on certain claims for all three defendants, the jury found that WBI was liable for only one claim: rigging the redemption drawing.¹⁴⁰ Cotten and WBI both appealed.¹⁴¹

In addressing Cotten's issue regarding breach of fiduciary duty and oppression, the court first noted that corporate officers generally owe a fiduciary duty only to the corporation, not to individual shareholders.¹⁴² Cotten failed to show that any kind of confidential relationship existed between him and Sharp or Stratham.¹⁴³ Accordingly, the court held that it was not error for the court to grant Sharp and Stratham's directed verdict motion on the breach of fiduciary duty issue.¹⁴⁴

Next, the court addressed Cotten's argument that the trial court erred by granting a directed verdict on his shareholder oppression claim.¹⁴⁵ The trial court had held no oppression could exist between common and preferred shareholders as a matter of law.¹⁴⁶ The court considered how other appellate courts and Black's Law Dictionary defined oppression.¹⁴⁷ The court particularly focused on the inherent conflicts resulting from the bank holding company structure.¹⁴⁸ The court said that because there was

¹³⁷ *Id.* at 695.

¹³⁸ *Id.*

¹³⁹ *Id.* at 694.

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² *Id.* at 698.

¹⁴³ *Id.*

¹⁴⁴ *Id.* at 699.

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* at 699–700.

¹⁴⁸ *Id.* at 700.

potential for oppressive conduct between directors and preferred shareholders, a cause of action existed for Cotten, as a preferred shareholder, against Sharp and his daughter.¹⁴⁹ It therefore reversed the directed verdict on this claim and remanded the claim for trial.¹⁵⁰

4. *Redmon v. Griffith*

The Tyler Court of Appeals articulated a particularly expansive view of shareholder oppression, by which plaintiffs could avoid restrictions on other causes of action.¹⁵¹ In *Redmon v. Griffith*, 25% minority shareholders sued the corporation (GEM) and the 75% majority shareholders on a variety of claims (including breach of fiduciary duty, shareholder oppression, and breach of contract) and also brought derivative claims in the name of GEM against the majority shareholders.¹⁵² After GEM filed bankruptcy, plaintiffs dismissed their direct claims against the company as well as their derivative claims.¹⁵³ The Redmons asserted the Griffiths had used corporate funds to pay personal expenses, diverted corporate opportunities, funds, and revenues, denied Jim Redmon access to financial records, and attempted to use oppressive or “squeeze-out” tactics.¹⁵⁴ The trial court granted summary judgment for the defendants and entered a take-nothing judgment.¹⁵⁵

The Court of Appeals reviewed each cause of action separately, addressing whether the plaintiffs had standing to assert each claim, then whether they presented sufficient evidence to avoid summary judgment.¹⁵⁶ In its preliminary analysis of standing, the court acknowledged several of the basic principles discussed earlier in this article: (1) corporate officers owe fiduciary duties to the corporation, but not to individual shareholders “unless some contract or special relationship exists between them in

¹⁴⁹ *Id.* (noting the following evidence of oppression: (1) there was evidence that Cotten was damaged by Sharp and Stratham furthering of their own interests as the common shareholders; and (2) Sharp and Stratham had tried to improperly redeem Cotten’s shares, which would have increased the capital under their control by reducing dividends that had to be paid to preferred shareholders).

¹⁵⁰ *Id.* at 710.

¹⁵¹ See *Redmon v. Griffith*, 202 S.W.3d 225 (Tex. App.—Tyler 2006, pet. denied).

¹⁵² *Id.* at 231.

¹⁵³ *Id.*

¹⁵⁴ *Id.* at 235–36.

¹⁵⁵ *Id.* at 231.

¹⁵⁶ *Id.* at 235.

addition to the corporate relationship”; (2) “a corporate shareholder has no individual cause of action for personal damages [such as diminution of stock value] caused solely by a wrong done to the corporation”; (3) a claim for injury to a corporation belongs to the entity, and may be brought by a shareholder only in a derivative capacity; and (4) an individual shareholder’s direct action against another shareholder or corporate officer must be predicated on “a duty arising from a contract or otherwise and owing directly” to the plaintiff.¹⁵⁷

The court observed, however, that some Texas courts had “recognized an individual cause of action for ‘shareholder oppression’ or ‘oppressive conduct.’”¹⁵⁸ The court then quoted the two “definitions” of oppressive conduct articulated in *Willis v. Bydalek* and noted that such a claim “can be independently supported by evidence of a variety of conduct.”¹⁵⁹ Unfortunately, the *Redmon* court never addressed any potential conflicts between the principles previously articulated and a broad application of a shareholder oppression cause of action. Consequently, the court held that the plaintiffs could pursue an oppression claim based on allegations and some evidence that the defendants “paid personal expenses from corporate funds without the approval of the board of directors.”¹⁶⁰

The court then considered the claim for breach of fiduciary duty and again reiterated the principle that the shareholder plaintiffs cannot assert an individual claim for breach of duties owed only to the corporation.¹⁶¹ Nevertheless, the court held that because plaintiffs had alleged “a great deal of control” by the 75% majority shareholder and a variety of “wrongful conduct,” they had established standing to pursue a claim for “breach of fiduciary duty by way of oppressive conduct.”¹⁶² Finally, the court held that because plaintiffs had offered some evidence of oppressive conduct, such as paying personal expenses with corporate funds, that evidence would suffice to defeat summary judgment on breach of fiduciary duty as well.¹⁶³

¹⁵⁷ *Id.* at 233–34.

¹⁵⁸ *Id.* at 334 (citations omitted).

¹⁵⁹ *Id.* (citing *Willis v. Bydalek*, 997 S.W.2d 798, 801 (Tex. App.—Houston [1st Dist.] 1999).

¹⁶⁰ *Id.* at 235.

¹⁶¹ *Id.* at 236–37.

¹⁶² *Id.* at 238.

¹⁶³ *See id.*

As for plaintiffs' breach of contract claim based on termination of their employment, the court held that any such agreement was with the corporation, for which the defendants were not liable.¹⁶⁴ Nevertheless, the court held that plaintiffs could assert "wrongful termination within the confines of their shareholder oppression claim."¹⁶⁵

The majority of plaintiffs' claims were remanded to the trial court.¹⁶⁶ No record of the ultimate disposition of those claims has been located. The court's opinion, however, has been cited in support of the broadest possible application of the shareholder oppression doctrine.¹⁶⁷

5. *Gibney v. Culver*

The Corpus Christi Court of Appeals took a more conservative approach.¹⁶⁸ *Gibney v. Culver* involved Micro-Blend, Inc., a close corporation that manufactured patented blending systems for making soft drinks.¹⁶⁹ Michael Gibney was the creator of the idea and one of the initial four shareholders, along with Roy Culver.¹⁷⁰ Culver was the chief executive officer from the time of formation.¹⁷¹ In 1995, the Board of Directors authorized a contract that would allow another of Culver's companies, Culver Interests, to make skids for Micro-Blend.¹⁷² This arrangement continued until 1997 when Culver Interests dissolved, at which point Culver Interests gave the equipment and material used in production to Micro-Blend.¹⁷³ Additionally, Culver, along with his brother, owned Ana-Tech, Inc., which supplied Micro-Blend's employees from Micro-Blend's inception until 2001.¹⁷⁴ Gibney claimed that while Ana-Tech was supposed

¹⁶⁴ *Id.* at 239.

¹⁶⁵ *Id.*

¹⁶⁶ *Id.* at 242.

¹⁶⁷ See, e.g., *Bohringer v. Konkell*, 404 S.W.3d 18, 32 (Tex. App.—Houston [1st Dist.] 2013, no pet.); *Natale v. Espy Corp.*, 2 F. Supp. 3d 93, 103 (D. Mass. 2014) (applying Texas law, citing *Redmon* as recognizing "breach of fiduciary duty claim 'by way of oppressive conduct'").

¹⁶⁸ See *Gibney v. Culver*, No. 13-06-112-CV, 2008 WL 1822767 (Tex. App.—Corpus Christi Apr. 24, 2008, pet. denied) (mem. op.).

¹⁶⁹ *Id.* at *1.

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.* at *2.

¹⁷³ *Id.*

¹⁷⁴ *Id.*

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 363

to be performing all payroll services and received \$4.93 million for it, Micro-Blend's secretary was really completing those services.¹⁷⁵

Gibney filed a shareholder derivative action and shareholder oppression suit against Culver, Culver Interests, and Micro-Blend.¹⁷⁶ The trial court granted a partial directed verdict on Gibney's fraud claim and, after finding no evidence of damages, granted directed verdict on the shareholder derivative action. Consequently, the sole claim before the jury was shareholder oppression.¹⁷⁷ The trial court ruled that the jury's answers supported a finding of shareholder oppression against Culver.¹⁷⁸

On appeal, the court overruled Gibney's issues regarding the derivative claim.¹⁷⁹ Next, the court considered Gibney's shareholder oppression claim.¹⁸⁰ First, the court held the jury's findings that Culver paid himself and his family members excessive compensation were not supported by sufficient evidence.¹⁸¹ Second, the court held this was clearly not a situation in which Gibney was being oppressed, noting that Gibney chose to remain a contract employee and not be put on salary, he received \$420,000 of stock payments from 1995 to 2004, and no other shareholder received payments from the corporation during the time that Gibney was not paid.¹⁸² Additionally, although Gibney alleged Culver maliciously and wrongfully refused him access to the corporation's books and records, the record did not reflect any written requests to look at the records.¹⁸³ The appellate court held it was an abuse of discretion for the trial court to conclude Gibney had proven a shareholder oppression claim.¹⁸⁴

6. Federal Cases

Federal courts applying Texas law have also addressed claims of shareholder oppression. In *Bulacher v. Enowa, L.L.C.*, Bulacher owned

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ *Id.* at *3.

¹⁷⁸ *Id.* at *4.

¹⁷⁹ *Id.*

¹⁸⁰ *Id.* at *12.

¹⁸¹ *Id.* at *12–13.

¹⁸² *Id.* at *17–18.

¹⁸³ *Id.* at *18.

¹⁸⁴ *Id.*

17% of Enowa.¹⁸⁵ He sued the corporation and members of management for breach of contract, shareholder oppression, and breach of fiduciary duty.¹⁸⁶ Bulacher claimed the defendants had oppressed him by: (1) using prepaid consultant fees to lower Enowa's income performance, which affected his quarterly bonuses; (2) terminating him to prevent him from reviewing important financial and business records of the company; (3) trying to induce him to allow Enowa to repurchase his stocks at a fraction of the value; and (4) making excessive bonuses and distributions to the defendants after he was terminated.¹⁸⁷

The court recognized a claim of shareholder oppression as defined in *Bydalek* and *Davis* and noted that Texas has applied a broad view of oppressive conduct to closely held corporations.¹⁸⁸ The court held that Bulacher had pleaded sufficient facts for a shareholder oppression claim and denied the defendants' motion to dismiss.¹⁸⁹

The United States Bankruptcy Court for the Eastern District of Texas also addressed shareholder oppression when C.L. Gage sought a judgment liquidating his claims against James and Sandra Rosenbaum.¹⁹⁰ The Rosenbaums formed a corporation, Cornerstone, which was to distribute goat de-wormer to commercial distributors.¹⁹¹ After having received three shipments of the goat de-worming pellets, the Rosenbaums and Cornerstone had no way to pay for any of the shipments.¹⁹² To induce Gage to invest in Cornerstone, James Rosenbaum made false representations about the intended use of the funds.¹⁹³ Gage invested \$252,800 initially and later contributed another \$71,600, which brought his ownership to 25% of Cornerstone.¹⁹⁴ The Rosenbaums and their daughter received over \$600,000 of compensation, though the Rosenbaums had represented to Gage they

¹⁸⁵No. 3:10-CV-156-M, 2010 WL 1135958, at *1 (N.D. Tex. Mar. 23, 2010).

¹⁸⁶*Id.*

¹⁸⁷*Id.* at *2.

¹⁸⁸*Id.* at *1–2.

¹⁸⁹*Id.* at *2.

¹⁹⁰*Gage v. Rosenbaum (In re Rosenbaum)*, No. 08-43029, Adv. Proc. No. 09-4023, 2010 Bankr. LEXIS 1509, at *1 (Bankr. E.D. Tex. May 7, 2010), *aff'd*, No. 4:10-CV-512, 2011 U.S. Dist. LEXIS 111759, (E.D. Tex. Sept. 29, 2011).

¹⁹¹*Id.* at *3–4.

¹⁹²*Id.* at *6.

¹⁹³*Id.* at *6–7, 9.

¹⁹⁴*Id.* at *7–9.

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 365

would not draw salaries initially, no contracts existed to substantiate their claim they were doing contract work, and no documentation showed the distributions were loans as they claimed.¹⁹⁵ Cornerstone never observed corporate formalities, nor did it ever distribute a dividend or other payment to Gage.¹⁹⁶

Gage's claims against the Rosenbaums included common law fraud, statutory fraud, breach of fiduciary duty, and shareholder oppression.¹⁹⁷ The court interpreted Texas law as imposing no set standard to determine if a shareholder has been oppressed, but instead requiring the court to determine whether the corporation's conduct deprived the shareholder of his reasonable expectations as a shareholder.¹⁹⁸ The court found Gage was oppressed by the Rosenbaums' concerted effort to control the business and their inducements to invest while secretly raiding all the assets of the corporation, which left the minority shareholders with worthless stock.¹⁹⁹ The court went on to find the Rosenbaums owed a fiduciary duty to Gage because they dominated control of the corporation, did not follow corporate formalities, and used the corporation as their "personal piggy bank."²⁰⁰ After finding the Rosenbaums' conduct also constituted fraud, the court awarded damages in the amount of Gage's investment and held the debt was not dischargeable.²⁰¹

The Bankruptcy Court for the Southern District of Texas narrowly upheld a shareholder oppression claim based on minority expectations in *In re White*.²⁰² To avoid double taxation, Four Seasons issued bonuses to employee-shareholders rather than issuing dividends.²⁰³ When White, an employee-shareholder, was terminated, he was no longer eligible for bonuses, so the bonus-over-dividend approach meant he was no longer receiving a proportionate share of corporate distributions.²⁰⁴ The court concluded the bonuses were disguised dividends, and the company was not

¹⁹⁵ *Id.* at *9–10, 12.

¹⁹⁶ *Id.* at *16–17.

¹⁹⁷ *Id.* at *18.

¹⁹⁸ *Id.* at *19.

¹⁹⁹ *Id.* at *20.

²⁰⁰ *Id.* at *21.

²⁰¹ *Id.* at *31–32.

²⁰² 429 B.R. 201, 202 (Bankr. S.D. Tex. 2010).

²⁰³ *Id.* at 207.

²⁰⁴ *Id.* at 208.

distributing the dividends proportionately, despite uncontroverted testimony that proportionate distribution was the board's intent.²⁰⁵ In reviewing the shareholder oppression claim, the court cited *Patton* and stated that a corporation that operates "to deprive a shareholder of its reasonable expectations to share in the corporation's profits has operated in an oppressive manner."²⁰⁶ The court noted that *Davis* had ordered a buy-out while *Patton* had issued an injunction mandating a dividend.²⁰⁷ Rather than decide between those options, the court elected to let the company choose which remedy it preferred, as the terminated shareholder would be made whole in either circumstance.²⁰⁸ Notably, the court used the shareholders' agreement to determine the buy-out price, should the company elect that option.²⁰⁹

C. Examining the Definitions

As Texas courts became increasingly willing to recognize a cause of action for shareholder oppression, they seemed to accept the two "definitions" of oppression derived from *Davis v. Sheerin* without questioning whether they were sufficiently definite to guide courts' decisions or were otherwise consistent with Texas law. Neither of these definitions are "sufficiently objective and particular to allow a reasonable assessment of the likelihood that certain behavior may be found to be culpable, and to adjudicate liability with some consistency in the various cases that arise."²¹⁰ The United States Supreme Court has held that a "law forbidding or requiring conduct in terms so vague that men of common

²⁰⁵ *Id.* at 210.

²⁰⁶ *Id.* at 214. The court also noted that the controlling shareholder diverted \$2,000,000 to his personal use. *Id.* at 215.

²⁰⁷ *Id.* at 215.

²⁰⁸ *Id.* at 216.

²⁰⁹ *Id.* at 217–18. The majority had not previously complied with the agreement, which included exercising an option to buy out employee-shareholders at the end of their employment. *Id.* at 211–13. Had they done so, the agreement presumably would have governed the relationship and the minority shareholder would no longer be a shareholder, nullifying the shareholder oppression claim. *See id.*

²¹⁰ *Twyman v. Twyman*, 855 S.W.2d 619, 629 (Tex. 1993) (Hecht, J., concurring and dissenting) (discussing standards appropriate for recognizing causes of action such as intentional infliction of emotional distress).

intelligence must necessarily guess at its meaning and differ as to its application violates due process of law.”²¹¹

1. “Fair Dealing”

Particularly problematic was the *Davis* court’s repetition of the Oregon Supreme Court’s review of various “definitions” of oppressive conduct employed by other courts, including such amorphous terms as “burdensome, harsh and wrongful conduct” or the “lack of probity and fair dealing.”²¹² These phrases are derived from fiduciary duty (or “good faith and fair dealing”) principles not compatible with Texas law, as discussed above.²¹³ Use of this “definition” of oppressive conduct thus “let[s] each case be decided upon what might seem ‘fair and in good faith’” by a jury, a result the Texas Supreme Court expressly rejected in *English v. Fischer* more than 30 years ago.²¹⁴

Moreover, the quoted phrases provide virtually no guidance in determining whether specific actions are actionable as “oppressive conduct.”²¹⁵ Even Professor Moll, a strong proponent of the shareholder oppression doctrine, acknowledges that the “vagueness of . . . [the] ‘wrongful’ or ‘unfair’ standard . . . is problematic, as it provides little coherent guidance regarding what constitutes oppressive conduct.”²¹⁶ Using pejorative terms such as “burdensome” or “harsh” to “define” a cause of action assumes a “breach” without first defining a duty, which is the threshold element of liability. As the Texas Supreme Court observed in

²¹¹ *Baggett v. Bullitt*, 377 U.S. 360, 367 (1964), *quoted in* *Cain v. Hearst Corp.*, 878 S.W.2d 577, 584 (Tex. 1994) (rejecting “false light” tort); *see also* *Boyles v. Kerr*, 855 S.W.2d 593, 599–600 (Tex. 1993) (rejecting “negligent infliction of emotional distress” because standard “fails to delineate meaningfully those situations where recovery should be allowed”).

²¹² *See* *Davis v. Sheerin*, 754 S.W.2d 375, 382 (Tex. App.—Houston [1st Dist.] 1988, writ denied) (quoting *Baker v. Commercial Body Builders, Inc.*, 507 P.2d 387, 393 (Or. 1973)).

²¹³ *See* *Willis v. Donnelly*, 199 S.W.3d 262, 277 (Tex. 2006); *Kaspar v. Thorne*, 755 S.W.2d 151, 155 (Tex. App.—Dallas 1988, no writ); *Pabich v. Kellar*, 71 S.W.3d 500, 504 (Tex. App.—Fort Worth 2002, pet. denied); *see also* *Formosa Plastics Corp. USA v. Presidio Eng’rs & Contractors, Inc.*, 960 S.W.2d 41, 52 (Tex. 1998) (Texas does not recognize “general duty of good faith and fair dealing” in commercial transactions).

²¹⁴ 660 S.W.2d 521, 522 (Tex. 1983).

²¹⁵ *See* *Davis*, 754 S.W.2d at 382 (noting Oregon court’s admission that such “definitions are of little value for application in a specific case”).

²¹⁶ Douglas K. Moll, *Shareholder Oppression & Reasonable Expectations: Of Change, Gifts, and Inheritances in Close Corporation Disputes*, 86 MINN. L. REV. 717, 781 (2002).

refusing to impose a duty of good faith and fair dealing on secured creditors, “[c]ommercial transactions require more predictability and certainty than this rule would afford.”²¹⁷ Finally, the onerous, quasi-fiduciary nature of the “oppression” claim places majority shareholders and directors at risk of liability for responsibly favoring the interests of the corporation over the desires of an individual shareholder (such as by preserving its capital instead of paying huge dividends).²¹⁸

2. “Reasonable Expectations”

The second “definition” quoted in *Davis* was derived from New York law and reflects an attempt to give a modicum of objective meaning to the concept of shareholder oppression, limiting such claims to situations in which “the majority’s conduct substantially defeats the expectations that objectively viewed were both reasonable under the circumstances and . . . central to the minority shareholder’s decision to join the venture.”²¹⁹ The New York approach has the virtue of not being predicated on a fiduciary duty or a duty of good faith, but it still gives little guidance for a jury to determine whether specific conduct will be deemed “oppressive.”²²⁰ Expectations of great financial success or perpetual harmony may well be objectively reasonable and material to the investment decision at the time of the original investment, but such expectations should not impose an obligation on other parties, especially where such expectations were not

²¹⁷ *FDIC v. Coleman*, 795 S.W.2d 706, 710 (Tex. 1990).

²¹⁸ See Paula J. Dalley, *The Misguided Doctrine of Stockholder Fiduciary Duties*, 33 *HOFSTRA L. REV.* 175, 190 (2004) (“If those in control of closely held corporations are required to consider the direct interests of minority stockholders, they may be required to make decisions that adversely affect the corporation, its other stockholders, and its creditors.”).

²¹⁹ *Davis*, 754 S.W.2d at 381 (citing *In re Wiedy’s Furniture Clearance Ctr. Co.*, 487 N.Y.S.2d 901, 903 (App. Div. 1985)). North Carolina has expanded the scope of reasonable expectations to “include the ‘reasonable expectations’ created at the inception of the participants’ relationship; those ‘reasonable expectations’ as altered over time; and the ‘reasonable expectations’ which develop as the participants engage in a course of dealing in conducting the affairs of the corporation.” *Meiselman v. Meiselman*, 307 S.E.2d 551, 563 (N.C. 1983).

²²⁰ See, e.g., Timothy J. Storm, *Remedies for Oppression of Non-Controlling Shareholders in Illinois Closely-Held Corporations: An Idea Whose Time Has Gone*, 33 *LOY. U. CHI. L.J.* 379, 435 (2002) (observing that under reasonable-expectation standards applied in Illinois, it is “essentially impossible to predict what conduct may be viewed in hindsight as oppressive”).

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 369

communicated to or shared by other shareholders or directors.²²¹ Courts and commentators have also struggled with how to deal with the “reasonable expectations” of a person who did not decide to invest in the venture, but obtained his or her shares through a gift or inheritance.²²² Another perceived problem with the reasonable-expectations test is that it can trigger liability “whether or not the majority acted wrongfully and even if the *minority* was guilty of misconduct.”²²³ In addition, the test has been criticized for not giving sufficient weight to the business judgment of those charged with the responsibility for managing the business in the interests of the entity.²²⁴

In short, this “definition,” though deceptively objective, does not provide a legal basis to set aside the principle of *Wingate* that a shareholder cannot sue directly for harm to the corporation, even if the harm to the company indirectly devastated his own investment.²²⁵ Nor does it justify enforcing purported “expectations” that were never memorialized in a shareholder agreement or other contract.²²⁶ Indeed, this standard can

²²¹ According to the Supreme Court of North Carolina, the key is to be “reasonable.” “In order for plaintiff’s expectations to be reasonable, they must be known to or assumed by the other shareholders and concurred in by them.” *Meiselman*, 307 S.E.2d at 563.

²²² See, e.g., *Guerra v. Guerra*, No. 04-10-00271-CV, 2011 Tex. App. LEXIS 6730, at *18 (Tex. App.—San Antonio Aug. 24, 2011, no pet.) (citing Douglas K. Moll, *Shareholder Oppression & Reasonable Expectations: Of Change, Gifts, and Inheritances in Close Corporation Disputes*, 86 MINN. L. REV. 717, 765–77 (2002)).

²²³ Robert C. Art, *Shareholder Rights & Remedies in Close Corporations: Oppression, Fiduciary Duties, and Reasonable Expectations*, 28 J. CORP. L. 371, 373 (2003) (emphasis added).

²²⁴ See Sandra K. Miller, *Should the Definition of Oppressive Conduct by Majority Shareholders Exclude a Consideration of Ethical Conduct and Business Purpose?*, 97 DICK. L. REV. 227, 232–34 (1993); Sandra K. Miller, *How Should U.K. and U.S. Minority Shareholder Remedies for Unfairly Prejudicial or Oppressive Conduct Be Reformed?*, 36 AM. BUS. L.J. 579, 632 (1999).

²²⁵ See *Wingate v. Hajdik*, 795 S.W.2d 717, 719 (Tex. 1990); *Nauslar v. Coors Brewing Co.*, 170 S.W.3d 242, 250 (Tex. App.—Dallas 2005, no pet.); *Emmett Props., Inc. v. Halliburton Energy Servs., Inc.*, 167 S.W.3d 365, 371 (Tex. App.—Houston [14th Dist.] 2005, pet. denied).

²²⁶ See, e.g., *Willis v. Bydalek*, 997 S.W.2d 798, 803 (Tex. App.—Houston [1st Dist.] 1999, pet. denied) (minority shareholders’ “expectations of continued employment, without a contract, [were not] ‘objectively reasonable’ . . . [because] Texas law does not recognize a minority shareholder’s right to continued employment without an employment contract”) (citations omitted); *Gibney v. Culver*, No. 13-06-112-CV, 2008 WL 1822767, at *18 (Tex. App.—Corpus Christi Apr. 24, 2008, pet. denied) (mem. op.) (rejecting oppression claim where by-laws did not require annual dividends and plaintiff received dividend payments in accordance with his shares);

“destroy one of the most important expectations a business person can have—predictability in the rules of the game.”²²⁷

III. THE *RITCHIE* TRILOGY IN THE DALLAS COURT OF APPEALS

Prior to March 2011, the Dallas Court of Appeals had not addressed whether shareholder oppression was a viable cause of action or weighed in on its parameters. However, in the next sixteen months, that court decided three cases that would ultimately change the face of Texas law.

A. *Ritchie v. Rupe*

Following the death of her husband Buddy Rupe, Ann Rupe became the trustee and beneficiary of “Buddy’s Trust,” which held 18% of the shares of Rupe Investment Corp. (“RIC”).²²⁸ The company’s president, Lee Ritchie, together with the other two directors, individually or as trustees of three other family trusts, controlled the remaining 82% of RIC’s shares.²²⁹ There was no shareholder agreement.²³⁰ Long-simmering family friction led Rupe to ask RIC to purchase her shares (i.e., those owned by Buddy’s Trust).²³¹ Rupe rejected RIC’s “highest cash offer” of \$1.7 million as inadequate and decided to try to sell the shares to a third party.²³² However, that effort was hampered by Ritchie’s refusal (on the advice of RIC’s counsel) to meet with prospective purchasers.²³³

Balias v. Balias, Inc., 748 S.W.2d 253, 257 (Tex. App.—Houston [14th Dist.] 1988, writ denied) (refusal to follow alleged “arrangement” not reflected in shareholder agreement or articles of incorporation was not “oppressive” conduct).

²²⁷ See Michael K. Molitor, *Eat Your Vegetables (Or at Least Understand Why You Should): Can Better Warning and Education of Prospective Minority Owners Reduce Oppression in Closely Held Businesses?*, 14 FORDHAM J. CORP. & FIN. L. 491, 556 (2009) (citing Daniel S. Kleinberger, *Why Not Good Faith? The Foibles of Fairness in the Law of Close Corporations*, 16 WM. MITCHELL L. REV. 1143, 1156 (1990)).

²²⁸ *Ritchie v. Rupe*, 339 S.W.3d 275, 282 (Tex. App.—Dallas 2011), *rev’d*, 443 S.W.3d 856 (Tex. 2014).

²²⁹ *Id.* at 281–82.

²³⁰ *Id.* at 282.

²³¹ *Id.*

²³² *Id.* at 282 n.6.

²³³ *Id.* at 282, 296 n.37.

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 371

Rupe then sued RIC and the three directors, alleging “oppressive” conduct and breach of fiduciary duties.²³⁴ She requested an accounting and valuation of RIC and an order that RIC purchase her shares at fair market value or, alternatively, a liquidating receivership.²³⁵ A jury found in Rupe’s favor and determined the “fair value” of her shares (with no minority or liquidity discounts) was \$7.3 million.²³⁶ The trial court entered judgment on the verdict, found RIC and its directors had acted “oppressively” on several grounds, and ordered RIC to purchase the shares of Buddy’s Trust for \$7.3 million.²³⁷

The Dallas Court of Appeals acknowledged the cause of action for shareholder oppression as other Texas courts had applied it, beginning with *Davis v. Sheerin*, and articulated a more defined framework for determining whether specific conduct may be deemed “oppressive.”²³⁸ The court followed *Davis* in linking the claim of shareholder oppression to the statutory provision authorizing a court-ordered receivership (where other remedies are inadequate) to rehabilitate a corporation if, *inter alia*, the court finds “the governing persons of the entity” engaged in “oppressive” actions.²³⁹ Noting that the statute does not define “oppressive” actions, the court focused on the “reasonable expectations” definition of shareholder oppression, i.e., “conduct that substantially defeats the minority’s expectations that, objectively viewed, were both reasonable under the circumstances and central to the minority shareholder’s decision to join the venture.”²⁴⁰ In articulating this standard, the court provided significantly more guidance than any previous Texas court.

Adopting a classification articulated by Professor Douglas Moll, the court distinguished between *general* and *specific* reasonable expectations.²⁴¹

²³⁴ *Id.* at 283.

²³⁵ *Id.*

²³⁶ *Id.* at 299.

²³⁷ *Id.* at 283.

²³⁸ *Id.* at 286.

²³⁹ TEX. BUS. ORGS. CODE ANN. § 11.404(a)(1)(C) (West 2012); *see Ritchie*, 339 S.W.3d at 285–86.

²⁴⁰ *Ritchie*, 339 S.W.3d at 289–90 (quoting *Willis v. Bydalek*, 997 S.W.2d 798, 801 (Tex. App.—Houston [1st Dist.] 1999, pet. denied)). The court also briefly discussed the “fair dealing” definition of oppression, noting that it “will often overlap the reasonable expectations definition.” *Id.* at 294.

²⁴¹ *Id.* at 290–91 (citing Moll, *supra* note 216, at 765–77).

It held that general reasonable expectations are those held by all shareholders by virtue of stock ownership, unless modified by a shareholder agreement or corporate governance documents.²⁴² These include “the right to proportionate participation in earnings, the right to any stock appreciation, . . . the right to vote if the stock has voting rights,” and the right to sell stock to another person “at a mutually acceptable price.”²⁴³ In contrast, it held that “a specific reasonable expectation . . . requires proof that a close corporation majority shareholder and a particular minority shareholder reached a mutual understanding about a certain entitlement the minority is to receive in return for its investment in the business.”²⁴⁴

Applying this analytical framework, the court found that because there were no restrictions on the sale of the company’s stock, Ritchie had a general reasonable expectation that she could market her stock to a third party.²⁴⁵ The majority’s refusal to meet with prospective purchasers “substantially defeated” that expectation and was therefore oppressive.²⁴⁶ The court held further that an order requiring RIC to redeem the minority’s shares was an appropriate equitable remedy authorized by the receivership statute, but “the trial court erred in ordering the Stock be purchased for a price that did not constitute fair market value.”²⁴⁷ The proper remedy for that oppressive conduct, the court held, was to require the defendants to buy her stock at “fair market value,” not the undiscounted “enterprise value” ordered by the trial court.²⁴⁸ Accordingly, the judgment was reversed and the case remanded to the trial court.²⁴⁹

B. ARGO Data Resources v. Shagrithaya

Shortly after its opinion in *Ritchie*, the Dallas court had an opportunity to apply the reasonable-expectations test to different facts.²⁵⁰ Max Martin

²⁴² See *id.* at 291.

²⁴³ *Id.* at 291–92.

²⁴⁴ *Id.* at 291 n.25 (quoting Moll, *supra* note 216, at 767).

²⁴⁵ *Id.* at 294.

²⁴⁶ *Id.* at 296.

²⁴⁷ *Id.* at 281.

²⁴⁸ *Id.* at 301.

²⁴⁹ *Id.* at 309.

²⁵⁰ See generally *ARGO Data Res. Corp. v. Shagrithaya*, 380 S.W.3d 249 (Tex. App.—Dallas 2012, pet. denied).

and Balkrishna Shagrithaya founded ARGO Data Resources in 1980 and are its only two shareholders.²⁵¹ Martin is the CEO and owns 53% of the stock, and Shagrithaya, who initially developed the company's core technology, owns the remaining 47%.²⁵² For more than 25 years, Martin and Shagrithaya were the only directors.²⁵³ ARGO grew into a profitable business with substantial cash reserves; the two shareholders received generous salaries, but the company paid no dividends until 2004.²⁵⁴ In 2005, Martin became frustrated with Shagrithaya's level of participation in the company and substantially reduced Shagrithaya's salary.²⁵⁵ Martin later offered to have the company buy back Shagrithaya's shares at fair market value (including minority discounts), which Shagrithaya rejected as a "low ball" offer.²⁵⁶ Shagrithaya demanded that Martin or ARGO buy Shagrithaya's shares with no minority discount, or that ARGO issue an \$85 million dividend.²⁵⁷

In December 2007, Shagrithaya sued Martin, asserting shareholder oppression and other claims in both individual and derivative capacities.²⁵⁸ A year later, ARGO's then three-person board voted to issue a \$25 million dividend, with Shagrithaya dissenting in favor of a much larger dividend.²⁵⁹ After a six-week trial ending in October 2009, the jury found for Shagrithaya on almost all claims.²⁶⁰ The trial court held that Shagrithaya was oppressed by Martin's conduct, and ordered an \$85 million dividend as an equitable remedy.²⁶¹ The court also awarded Shagrithaya damages and attorney's fees on his other claims.²⁶²

In pretrial and post-trial briefing, ARGO and Martin challenged whether shareholder oppression was a viable cause of action; argued that neither of the two repeated definitions of oppressive conduct was compatible with

²⁵¹ *Id.* at 258.

²⁵² *Id.*

²⁵³ *Id.*

²⁵⁴ *Id.*

²⁵⁵ *Id.* at 259.

²⁵⁶ *Id.* at 259–60.

²⁵⁷ *Id.* at 261–62.

²⁵⁸ *Id.* at 262.

²⁵⁹ *Id.* at 262–63.

²⁶⁰ *Id.* at 263.

²⁶¹ *Id.*

²⁶² *Id.* at 263.

Texas law; and argued that, under any definition, Martin's conduct was not oppressive.²⁶³

While the case was on appeal, the Dallas court issued its opinion in *Ritchie*, distinguishing the general and specific reasonable expectations of minority shareholders.²⁶⁴ A different panel of the court then applied the newly articulated *Ritchie* analysis to the acts found by the jury in *ARGO* and held that none of the enumerated acts defeated Shagrithaya's reasonable expectations (general or specific) as a minority shareholder.²⁶⁵ The court also found the trial court's findings of "malicious suppression of dividends" and fraud, as well as the jury verdict for breach of contract, were not supported by legally sufficient evidence.²⁶⁶ It therefore reversed and rendered judgment that Shagrithaya take nothing.²⁶⁷

C. Cardiac Perfusion Services v. Hughes

The third case in the trilogy, *Cardiac Perfusion Services, Inc. v. Hughes*, involved another two-shareholder corporation.²⁶⁸ Randall Hughes was an employee of Cardiac Perfusion Services ("CPS"), which is owned and controlled by Michael Joubran.²⁶⁹ In 1992, Joubran sold Hughes ten percent of the company and retained the other ninety percent.²⁷⁰ In connection with that sale, the two shareholders signed a Buy-Sell Agreement providing that, in the event Hughes's employment was terminated, his shares would be

²⁶³ See, e.g., Defendant Argo Data Res. Corp.'s Motion for Directed Verdict and Brief in Support at 3, 11, *Shagrithaya v. Martin*, No. 07-15149-I (162d Dist. Ct., Dallas County, Tex. Oct. 8, 2009); Defendant Martin's Motion for Judgment Notwithstanding the Verdict and to Disregard Jury Findings on Equitable Claim for Additional Dividend at 2–14, *Shagrithaya v. Martin*, No. 07-15149-I (162d Dist. Ct., Dallas County, Tex. Feb. 2, 2010); Defendant Argo Data Res. Corp.'s Response in Opposition to Plaintiff's Motion to Disregard Jury Findings and For Judgment Notwithstanding the Verdict at 4–5, *Shagrithaya v. Martin*, No. 07-15149-I (162d Dist. Ct., Dallas County, Tex. Mar. 5, 2010).

²⁶⁴ *Ritchie v. Rupe*, 339 S.W.3d 275, 290–292 (Tex. App.—Dallas 2011), *rev'd*, 443 S.W.3d 856 (Tex. 2014).

²⁶⁵ *ARGO*, 380 S.W.3d at 270, 273.

²⁶⁶ *Id.* at 273.

²⁶⁷ *Id.* at 276.

²⁶⁸ See generally 380 S.W.3d 198 (Tex. App.—Dallas 2012), *rev'd*, 436 S.W.3d 790 (Tex. 2014).

²⁶⁹ *Id.* at 201.

²⁷⁰ *Id.*

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 375

purchased by Joubran or the company at their book value as of the end of the preceding year.²⁷¹ Hughes remained an at-will employee.²⁷²

Many years later, a dispute arose, and Joubran fired Hughes.²⁷³ When CPS and Joubran sued for declaratory relief to enforce the Buy-Sell Agreement, Hughes counterclaimed for shareholder oppression.²⁷⁴ Hughes's employment termination was not argued or found to be oppressive or otherwise improper.²⁷⁵ Based on jury findings concerning Joubran's handling of the company's assets, the trial court held Joubran's conduct was oppressive.²⁷⁶ Rejecting Joubran's argument that the Buy-Sell Agreement defined the shareholders' reasonable expectations and governed any buyout of Hughes's shares in these circumstances, the court ordered Joubran and CPS to buy Hughes's shares in CPS for \$300,000, the undiscounted "fair value" found by the jury.²⁷⁷ Another panel of the Dallas Court of Appeals affirmed, based in part on its interpretation of *Ritchie*.²⁷⁸

D. Impact on Cases in Other Courts

Building on this trio of cases, other Texas courts accepted shareholder oppression as a part of Texas jurisprudence and applied the newly articulated standards to other claims of wrongful conduct.²⁷⁹

For example, applying *Ritchie*'s reasonable-expectation analysis, the Houston First Court of Appeals refused to find shareholder oppression in *Batey v. Droluk*.²⁸⁰ That case involved a company originally owned by Paul

²⁷¹ *Id.*

²⁷² *See id.*

²⁷³ *Id.*

²⁷⁴ *Id.*

²⁷⁵ *See id.* at 201–02.

²⁷⁶ *Id.* at 202.

²⁷⁷ *Id.*

²⁷⁸ *Id.* at 203, 214.

²⁷⁹ *See, e.g., In re Trockman*, No. 07-11-0364-CV, 2012 Tex. App. LEXIS 1341, at *5 (Tex. App.—Amarillo February 21, 2012, no pet.) (citing *Ritchie* and stating that "oppression claims have been recognized as part of Texas' jurisprudence"); *Feldman v. Kim*, No. 14-11-00184-CV, 2012 Tex. App. LEXIS 3155, at *7–8 (Tex. App.—Houston [14th Dist.] April 24, 2012, no pet.) (citing *Ritchie* and stating that "Texas recognizes a cause of action for shareholder oppression").

²⁸⁰ No. 01-12-01058-CV, 2014 Tex. App. LEXIS 3979 (Tex. App.—Houston [1st Dist.] April 10, 2014, no pet.).

Droluk.²⁸¹ He hired JoAnn Batey as one of his early employees, and eventually married her and transferred over half the company to her.²⁸² After the execution of a post-marital agreement and a divorce from Batey, Droluk was once again the majority shareholder of the company.²⁸³ The relationship between Batey and Droluk deteriorated, and Droluk eventually forbade Batey from coming on company premises except for board meetings, forbade her from contacting company employees, changed the locks, and denied her access to the company's outside accountant.²⁸⁴ She brought a shareholder derivative claim and sued directly for breach of fiduciary duty and shareholder oppression.²⁸⁵ The trial court ruled against Batey after a bench trial, and she appealed.²⁸⁶ The appellate court reviewed the company's bylaws and an agreement executed by the shareholders in 2002, considered Batey's past involvement with the company, and determined that Droluk's alleged conduct did not defeat any of Batey's reasonable expectations and was not oppressive.²⁸⁷

The same court found that the majority's conduct did defeat the minority's reasonable expectations in *Boehringer v. Konkel*.²⁸⁸ *Boehringer* owned 50.1% of the company and was the president while *Konkel* owned 49.9% and was the vice president.²⁸⁹ Their annual salaries were set at \$60,000 each.²⁹⁰ After a few years, the relationship between the two men deteriorated.²⁹¹ *Konkel* made multiple requests to review the company's books and records, which *Boehringer* largely ignored.²⁹² Then, after vowing to make *Konkel*'s "fucking life miserable," *Boehringer* used his majority position to replace *Konkel* as vice president with *Boehringer*'s wife, make the company's "Subchapter S status revocable upon his own behest," place restrictions on the sale of stock, and increase his own salary to \$240,000

²⁸¹ *Id.* at *2.

²⁸² *Id.*

²⁸³ *Id.*

²⁸⁴ *Id.* at *3–6.

²⁸⁵ *Id.* at *6–7.

²⁸⁶ *Id.* at *8–11.

²⁸⁷ *Id.* at *42.

²⁸⁸ 404 S.W.3d 18, 33 (Tex. App.—Houston [1st Dist.] 2013, no pet.).

²⁸⁹ *Id.* at 22.

²⁹⁰ *Id.* at 29.

²⁹¹ *Id.* at 23.

²⁹² *Id.*

(while reducing Konkel's salary to \$48,000).²⁹³ In addition, Boehringer abandoned the parties' practice of issuing yearly dividends.²⁹⁴

The trial court found, and the court of appeals agreed, that Boehringer's conduct violated Konkel's reasonable expectations and constituted shareholder oppression as a matter of law.²⁹⁵ Relying on *ARGO*, the court noted that Konkel did not have a reasonable expectation regarding his own salary, but that he did reasonably expect Boehringer would not pay himself an excessive salary.²⁹⁶ The court likewise acknowledged that Konkel did not have a general expectation of receiving dividends, but that Boehringer could not, through the payment of an excessive salary, award himself a de facto dividend to the exclusion of Konkel.²⁹⁷ The court therefore affirmed the trial court's judgment ordering that the corporation be liquidated and the net proceeds split between the two shareholders.²⁹⁸

Kohannim v. Katoli involved a company owned in equal shares by Jacob Kohannim and Mike Khosravikatoli.²⁹⁹ Mike was married to Parvaneh Katoli, and she was awarded his share of the company through their divorce proceeding.³⁰⁰ Before the divorce decree was entered, however, Jacob transferred \$160,000 out of the company's bank account.³⁰¹ He also "paid himself \$100,000 for management services that were not performed and failed to make any profit distributions . . . even though more than \$250,000 in undistributed profit had accumulated in the company's accounts."³⁰² Relying on a provision in the company's regulations requiring the distribution of "available cash" to members, the court held that Jacob's refusal to make distributions was oppressive.³⁰³ In calculating the value of Parvaneh's shares to determine her damages, the court refused to credit the provisions in the company's regulations addressing the valuation of

²⁹³ *Id.*

²⁹⁴ *Id.* at 29.

²⁹⁵ *Id.* at 33.

²⁹⁶ *Id.* at 29–30.

²⁹⁷ *Id.* at 31.

²⁹⁸ *Id.* at 33.

²⁹⁹ 440 S.W.3d 798, 804 (Tex. App.—El Paso 2013, pet. denied).

³⁰⁰ *Id.* at 805.

³⁰¹ *Id.*

³⁰² *Id.* at 813.

³⁰³ *Id.*

shares.³⁰⁴ Citing *Cardiac Perfusion*, the court held that the provisions in the regulations addressed the valuation of shares in the case of death, dissolution, retirement, or bankruptcy of a member, and did not apply where oppression was alleged.³⁰⁵

In *Feldman v. Kim*, the court of appeals reversed summary judgment in favor of defendants and held that the plaintiff had stated a viable cause of action for shareholder oppression.³⁰⁶ The plaintiff in that case was one of five doctors who owned a medical office.³⁰⁷ When the plaintiff announced he planned to wind down his practice and retire, the other four owners voted to change the practice of allocating both revenues and expenses among the owners in proportion to each doctor's volume of referrals to a system where the expenses were shared pro rata among the five doctors, but the revenues were shared according to volume of referrals.³⁰⁸ In this way, the defendants "plac[ed] Feldman in the position of subsidizing returns for his associates while receiving none himself."³⁰⁹ The court held this fact alone was sufficient to defeat summary judgment on the oppression claim.³¹⁰ The case was therefore remanded to the trial court, and the defendants did not request review by the Texas Supreme Court.³¹¹

IV. THE TEXAS SUPREME COURT CHARTS ITS OWN COURSE

A. *Ritchie v. Rupe*

While the Texas appellate courts were adjusting to and applying the new rules articulated by the Dallas Court of Appeals, the Texas Supreme Court was reviewing those cases as well. The Court initially denied the petition for review in *Ritchie*,³¹² but reconsidered that ruling and requested full

³⁰⁴ *Id.* at 815.

³⁰⁵ *Id.* at 815–16.

³⁰⁶ No. 14-11-00184-CV, 2012 Tex. App. LEXIS 3155, at *1, 14 (Tex. App.—Houston [14th Dist.] Apr. 24, 2012, no pet.). The court cited the Dallas court's opinion in *Ritchie* and other cases discussed above.

³⁰⁷ *Id.* at *1–2.

³⁰⁸ *Id.* at *3–4.

³⁰⁹ *Id.* at *11.

³¹⁰ *Id.*

³¹¹ *Id.* at *12.

³¹² *Ritchie v. Rupe*, No. 11-0447, 2011 Tex. LEXIS 590 (Tex. Aug. 12, 2011).

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 379

briefs on the merits.³¹³ The Ritchie parties argued, *inter alia*, that shareholder oppression is solely a statutory cause of action that cannot support non-statutory remedies such as a buy-out.³¹⁴ They also argued that the “fair dealing” definition was the appropriate test under the circumstances because it focuses on the majority’s motivation and good faith, and insisted the majority’s conduct, properly viewed in context, was not “oppressive.”³¹⁵

Rupe defended the lower courts’ finding of oppression and the buy-out remedy, and did not seek review of the appellate court’s remand for a fair market valuation.³¹⁶ Rupe’s brief described the appellate court’s opinion as “the essence of judicial restraint, confining itself to the specific facts, deciding the case on the narrowest possible grounds, and limiting its import to these parties and this particular set of circumstances.”³¹⁷ Accordingly, Rupe urged the Court to decline the invitation of amicus writers to provide broad guidance in this area of the law, insisting “the Court would be better served by waiting for another case with different facts.”³¹⁸ Alternatively, Rupe argued that the judgment should be affirmed based on the jury’s finding of a breach of an “informal” fiduciary duty, which would justify equitable relief, including the mandatory buyout.³¹⁹

In addition to the parties’ briefs, the Court received amicus briefs in support of petitioners and respondent. Several *amici* urged the Court to grant the petition and provide guidance to Texas courts and businesses concerning the respective rights and responsibilities of majority and

³¹³ *Ritchie v. Rupe*, No. 11-0447, 2012 Tex. LEXIS 907 (Tex. Oct. 26, 2012).

³¹⁴ Petitioners’ Brief on the Merits at 24, *Ritchie v. Rupe*, 443 S.W.3d 856 (Tex. 2014) (No. 11-0447).

³¹⁵ *Id.* at 42.

³¹⁶ Respondent’s Brief on the Merits at 22, *Ritchie v. Rupe*, 443 S.W.3d 856 (Tex. 2014) (No. 11-0447).

³¹⁷ *Id.* at 34.

³¹⁸ *Id.*

³¹⁹ *Id.* at 35–37. The jury found the Ritchie parties, in their capacity as trustees of family trusts that owned 70% of RIC’s stock, had a “relationship of trust and confidence” with Rupe (in her capacity as trustee of a different trust holding 18%), and did not comply with their fiduciary duties arising from that relationship. *Id.* at 35. The court also instructed the jury that a majority shareholder owes a fiduciary duty to the minority shareholder if “the majority shareholder dominates control over the business.” *Id.* at 35–36. The court of appeals did not address these issues. *Ritchie v. Rupe*, 339 S.W.3d 275, 302 (Tex. App.—Dallas 2011), *rev’d*, 443 S.W.3d 856 (Tex. 2014).

minority shareholders in closely held corporations and limited liability companies.³²⁰ Others, including a group of law professors, generally supported the shareholder-oppression doctrine as it had been developed by the Texas appellate courts and other states as necessary to protect minority shareholders, who are “peculiarly vulnerable to abuse.”³²¹ The Texas Trial Lawyers Association went even further and asked the Court to hold that determining whether particular conduct was oppressive is a question of fact, not law, and therefore should be presented to the jury in a broad-form question with appropriate instructions.³²²

Sixteen months after hearing argument in *Ritchie*, and eight months after receiving full briefing on the merits in the *ARGO* and *Cardiac Perfusion* cases, the Texas Supreme Court issued its landmark decision in *Ritchie*.³²³ The Court’s six-justice majority, in an opinion by Justice Boyd, held there is no common-law cause of action for shareholder oppression in closely held corporations under Texas common law, and that the statute referring to “oppressive” conduct by those in control of a corporation does not authorize a buy-out order or any remedy other than the “rehabilitative receivership” provided by that statute.³²⁴ The Court rejected both the “reasonable expectations” and “fair dealing” definitions of oppression, and held that Texas law provides adequate remedies to address the harms for which other courts had created the shareholder oppression cause of action.³²⁵

³²⁰ See Amicus Curiae Brief of John R. Fahay et al. In Support of Petition for Review at 1–2, *Ritchie v. Rupe*, 443 S.W.3d 856 (Tex. 2014) (No. 11-0447); Amicus Letter of Elizabeth S. Miller at 1, *Ritchie v. Rupe*, 443 S.W.3d 856 (Tex. 2014) (No. 11-0447); Amicus Letter of Carol Bavousett Mattick at 1, 4, *Ritchie v. Rupe*, 443 S.W.3d 856 (Tex. 2014) (No. 11-0447).

³²¹ Amicus Letter of Steinberg et al. at 4, *Ritchie v. Rupe*, 443 S.W.3d 856 (Tex. 2014) (No. 11-0447); see also Brief of Amicus Erwin Cruz, M.D. at 1–2, *Ritchie v. Rupe*, 443 S.W.3d 856 (Tex. 2014) (No. 11-0447).

³²² Brief of Amicus Curiae Texas Trial Lawyers Association at 13–16, *Ritchie v. Rupe*, 443 S.W.3d 856 (Tex. 2014) (No. 11-0447). Every Texas court to address this issue, beginning with *Davis*, has held that whether specific conduct was oppressive is a question of law. See, e.g., *Davis v. Sheerin*, 754 S.W.2d 375, 380 (Tex. App.—Houston [1st Dist.] 1988, writ denied); *Ritchie*, 339 S.W.3d at 285; Brief of Amicus Curiae Texas Trial Lawyers Association at 13–16, *Ritchie v. Rupe*, 443 S.W.3d 856 (Tex. 2014) (No. 11-0447).

³²³ *Ritchie v. Rupe*, 443 S.W.3d 856, 856 (Tex. 2014).

³²⁴ *Id.* at 860.

³²⁵ *Id.* at 891.

1. Oppressive Actions Under the Receivership Statute

First, the Court analyzed the meaning of “oppressive” conduct under §11.404 of the Texas Business Organizations Code, which authorizes appointment of a receiver to rehabilitate a domestic entity under certain circumstances,³²⁶ including where a shareholder establishes “that the acts of the directors or those in control of the corporation are illegal, oppressive or fraudulent.”³²⁷ It reviewed several cases construing this language, starting with cases narrowly construing it³²⁸ and moving on to *Davis v. Sheerin* and its progeny.³²⁹ The Court then conducted a thorough statutory-construction analysis, viewing “oppressive” in the context of the general requirements for receivership and the grounds for receivership in other subsections as well as the related terms “illegal” and “fraudulent” in subsection (c).³³⁰ The Court concluded “that neither the ‘fair dealing’ test nor the ‘reasonable expectations’ test sufficiently captures the Legislature’s intended meaning.”³³¹ Rather, the Court determined:

[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.³³²

Applying this standard, the Court easily found that the Ritchie parties’ refusal to meet with Rupe’s potential buyers was not oppressive.³³³ Although it recognized that Rupe was left in a “difficult situation,” the

³²⁶*Id.* at 863 (citing TEX. BUS. ORGS. CODE ANN. § 11.404 (West 2012), and its predecessor TEX. BUS. CORP. ACT art. 7.05 (expired Jan. 1, 2010)).

³²⁷*Id.* at 864 (citing TEX. BUS. ORGS. CODE ANN. § 11.404(a)(1)(c)); *see also* its predecessor, TEX. BUS. CORP. ACT art. 7.05(A)(1)(c).

³²⁸*Ritchie*, 443 S.W.3d at 854 (citing *Texarkana Coll. Bowl, Inc. v. Phillips*, 408 S.W.2d 537, 539 (Tex. Civ. App.—Texarkana 1966, no writ); *Balias v. Balias, Inc.*, 748 S.W.2d 253, 257 (Tex. App.—Houston [14th Dist.] 1988, writ denied)).

³²⁹*Ritchie*, 443 S.W.3d at 865–66.

³³⁰*Id.* at 866–71.

³³¹*Id.* at 870.

³³²*Id.* at 871.

³³³*Id.*

Court noted that such difficulties could be addressed and resolved by “shareholder agreements that contain buy-sell, first refusal, or redemption provisions that reflect [the parties’] mutual expectations and agreements.”³³⁴

Next, although Rupe had alleged other “oppressive” acts, the Court decided not to consider them because Rupe did not request the only remedy authorized by the statute—a rehabilitative receivership.³³⁵ The Court expressly rejected the holding in *Davis* and several cases that the statute “authorizes Texas courts to invoke their ‘general equity power’ to award a buyout of stock as a remedy for oppressive actions under the statute.”³³⁶ According to the Court, those cases had misconstrued the statutory reference to “other available legal and equitable remedies” and the holding of *Patton* in 1955.³³⁷

2. Shareholder Oppression Under Texas Common Law

Noting that several Texas cases (including *Cardiac Perfusion*) had relied on *Davis* and its progeny “to recognize a common-law claim for ‘shareholder oppression’ not based on any statutory authority,”³³⁸ the Court considered whether it should recognize such a claim. To make this determination, the Court employed “something akin to a cost-benefit analysis” as it had done in previous situations.³³⁹ Specifically, it considered:

- the foreseeability, likelihood, and magnitude of the risk of injury;
- the existence and adequacy of other protections against the risk;

³³⁴ *Id.*

³³⁵ *Id.* at 872.

³³⁶ *Id.* at 876 (quoting *ARGO Data Res. Corp. v. Shagrithaya*, 380 S.W.3d 249, 265 (Tex. App.—Dallas 2012, pet. denied)).

³³⁷ *See id.*

³³⁸ *Id.* at 877 (also citing *Boehringer v. Konkel*, 404 S.W.3d 18, 32–33 (Tex. App.—Houston [1st Dist.] 2013, no pet.); *Redmon v. Griffith*, 202 S.W.3d 225, 234 (Tex. App.—Tyler 2006, pet. denied); *Cotten v. Weatherford Bancshares, Inc.*, 187 S.W.3d 687, 699–701 (Tex. App.—Fort Worth 2006, pet. denied); *Gonzalez v. Greyhound Lines, Inc.*, 181 S.W.3d 386, 392 n.5 (Tex. App.—El Paso 2005, pet. denied); *Pinnacle Data Servs. Inc. v. Gillen*, 104 S.W.3d 188, 196 (Tex. App.—Texarkana 2003, no pet.); *Willis v. Bydalek*, 997 S.W.2d 798, 801 (Tex. App.—Houston [1st Dist.] 1999, pet. denied).

³³⁹ *Ritchie*, 443 S.W.3d at 878 (quoting *Roberts v. Williamson*, 111 S.W.3d 113, 118 (Tex. 2003)).

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 383

- the magnitude of the burden of guarding against the injury and the consequences of placing that burden on the persons in question; and
- the consequences of imposing the new duty, including:
 - whether Texas’s public policies are served or disserved;
 - whether the new duty may upset legislative balancing-of-interests; and
 - the extent to which the new duty provides clear standards of conduct so as to deter undesirable conduct without impeding desirable conduct or unduly restricting freedoms.³⁴⁰

Based on its detailed consideration of each of these factors,³⁴¹ the Court determined it would not “recognize a common-law cause of action for ‘shareholder oppression.’”³⁴² 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.³⁴³

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.”³⁴⁴ To be effective, of course, such agreements must be enforced. The Court criticized the decision in *Cardiac Perfusion*, which “affirmed a buyout of minority shares in direct contravention of the terms of the parties’ buy-out agreement.”³⁴⁵

The Court also emphasized that it must “consider whether the new duty would provide clear standards that would deter the undesirable conduct without deterring desirable conduct or unduly restricting freedoms.”³⁴⁶ Neither the “fair dealing” nor “reasonable expectation” test satisfied this requirement.³⁴⁷ “Ultimately, because the standard is so vague and subject to

³⁴⁰ *Id.*

³⁴¹ *See id.* at 878–91.

³⁴² *Id.* at 891.

³⁴³ *See id.*

³⁴⁴ *Id.* at 881, 885 n.52, 886.

³⁴⁵ *Id.* at 881 n.43.

³⁴⁶ *Id.* at 889.

³⁴⁷ *See id.* at 889–90.

so many different meanings in different circumstances, we conclude that creating new and independent legal remedies for ‘oppressive’ actions is simply bad jurisprudence.”³⁴⁸ Additionally, the Court held:

Imposing on directors and officers a common-law duty not to act “oppressively” against individual shareholders is the equivalent of, or at least closely akin to, imposing . . . a fiduciary duty We have not previously recognized a formal fiduciary duty to individual shareholders, and we believe that better judgment counsels against doing so.³⁴⁹

The Court therefore reversed the judgment of the Dallas Court of Appeals and remanded for consideration of the breach-of-fiduciary-duty claim not previously reached by that court.³⁵⁰

3. The *Ritchie* Dissent

The dissent in *Ritchie*, written by Justice Guzman and joined by Justices Willett and Brown, would have affirmed the judgment under the common-law definitions of shareholder oppression utilized by *Davis* and its progeny, as well as other jurisdictions.³⁵¹ They believed additional protections were necessary because the “structure of closely held corporations situates minority shareholders in positions uniquely vulnerable to abuse.”³⁵²

The dissent disagreed with the majority’s holding that the Texas receivership statute only allows for the remedy of receivership.³⁵³ It reasoned that the receivership statute’s mandate that receivership be available only when “all other remedies either at law or in equity” are inadequate demonstrated that the statutory language “*prefers* other remedies” and “does not extinguish them.”³⁵⁴ The dissent also took issue with the majority’s definition of “oppressive,” which includes an element of business judgment and requires harm to the corporation, as well as the

³⁴⁸ *Id.* at 890.

³⁴⁹ *Id.*

³⁵⁰ *Id.* at 892.

³⁵¹ *Id.* at 909 (Guzman, J., dissenting).

³⁵² *Id.* at 893 (citing *Hollis v. Hill*, 232 F.3d 460, 467 (5th Cir. 2000)).

³⁵³ *Id.* at 897.

³⁵⁴ *Id.* at 897–98 (emphasis in original).

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 385

minority shareholder.³⁵⁵ It quoted a New York court's observation that "[w]hether the controlling shareholders discharged petitioner for cause or in their good business judgment is irrelevant; rather, what was relevant was the minority shareholder's 'reasonable expectations.'"³⁵⁶ The dissent also criticized the majority for "shielding majority shareholders and directors from liability for decisions that do not harm the corporation or that were made in the honest exercise of business judgment."³⁵⁷

The dissent also disagreed with the majority's refusal to recognize a common law cause of action for shareholder oppression, noting that the Court's ruling creates a "gap" in the protection of minority shareholders "for oppression that harms minority shareholders but not the corporation."³⁵⁸

Rupe filed a motion for rehearing, which included a *pro forma* request that the Court "adopt the dissenting opinion as its own."³⁵⁹ The motion focused on a request for a remand to the trial court to allow Rupe to pursue a shareholders' derivative claim, as the Court had done in *Cardiac Perfusion*.³⁶⁰ Her motion prompted two lengthy amicus briefs supporting rehearing, which criticized the Court's opinion as entirely misguided.³⁶¹

B. *Completing the Trilogy*

One week after reversing the judgment in *Ritchie*, the Court denied the petition for review in *Shagrithaya*, thus preserving the take-nothing judgment on all counts.³⁶² The same day, the Court issued a *per curiam* opinion in *Cardiac Perfusion*, granting the petition and reversing "the part of the court of appeals' judgment affirming the trial court's buy-out order and denial of Joubran's and CPS's request for declaratory judgment."³⁶³

³⁵⁵ *Id.* at 903.

³⁵⁶ *Id.* at 901 (quoting *In re Topper*, 433 N.Y.S.2d 359, 362 (N.Y. Sup. Ct. 1980)).

³⁵⁷ *Id.* at 903.

³⁵⁸ *Id.* at 904.

³⁵⁹ Respondent's Motion for Rehearing and to Modify Judgment at 5, *Ritchie v. Rupe*, 443 S.W.3d 856 (Tex. 2014) (No. 11-0447).

³⁶⁰ *Id.* at 2-4.

³⁶¹ Brief of Amicus Erwin Cruz, M.D., *Ritchie v. Rupe*, 443 S.W.3d 856 (2014) (No. 11-0447); Chan Amicus Brief, *Ritchie v. Rupe*, 443 S.W.3d 856 (2014) (No. 11-0447).

³⁶² *Shagrithaya v. ARGO Data Res. Corp.*, No. 12-1012, 2014 Tex. LEXIS 535 (Tex. June 27, 2014).

³⁶³ *Cardiac Perfusion Servs., Inc. v. Hughes*, 436 S.W.3d 790, 793 (Tex. 2014).

The Court noted, however, that when it rejected the common-law cause of action for shareholder oppression in *Ritchie*, it “did so in part because of the adequacy of other existing legal protections.”³⁶⁴ It therefore remanded to the trial court to allow Hughes an opportunity to pursue his claims as a derivative action, suggesting he “may have proceeded under the wrong legal theory,” but expressing “no opinion on whether Hughes may successfully pursue such a claim.”³⁶⁵

V. SHAREHOLDER DISPUTES IN OTHER STATES

Although the Texas Supreme Court departed from the majority of states by refusing to recognize a cause of action for shareholder oppression, in many ways *Ritchie* brings Texas law in line with certain patterns other jurisdictions follow regarding shareholder claims. To be sure, *Ritchie* puts Texas squarely in the minority by declining to recognize shareholder oppression as a claim (at least, for any remedy other than receivership). As Justice Guzman’s dissent in *Ritchie* notes, thirty-six states have statutes that allow for liquidation for oppressive or similar conduct.³⁶⁶ Most of those states allow for lesser remedies as well, either expressly in the statute³⁶⁷ or

³⁶⁴ *Id.* at 792.

³⁶⁵ *Id.*

³⁶⁶ *Ritchie v. Rupe*, 443 S.W.3d 856, 894–895 (Tex. 2014) (Guzman, J., dissenting) (citing ALA. CODE § 10-2A-1430 (2015); ALASKA STAT. § 10.06.628 (2015); ARK. CODE ANN. § 4-27-1430 (2015); CAL. CORP. CODE § 1800 (West 2015); COLO. REV. STAT. § 7-114-301 (2015); CONN. GEN. STAT. § 33-896 (2015); GA. CODE ANN. § 14-2-940 (2015); IDAHO CODE ANN. § 30-1-1430 (2015); 805 ILL. COMP. STAT. 5/12.55 (2015); IOWA CODE § 490.1430 (2015); MD. CODE ANN., CORPS. & ASS’NS § 3-413 (2015); MICH. COMP. LAWS § 450.1489 (2015); MINN. STAT. § 302A.751 (2015); MISS. CODE ANN. § 79-4-14.30 (2015); MO. ANN. STAT. § 351.494 (2015); MONT. CODE ANN. § 35-1-938 (2015); NEB. REV. STAT. § 21-2985 (2015); N.H. REV. STAT. ANN. § 293-A:14.30 (2015); N.J. STAT. ANN. § 14A:12-7 (West 2015); N.M. STAT. ANN. § 53-16-16 (2015); N.Y. BUS. CORP. LAW § 1104-a (McKinney 2015); N.C. GEN. STAT. § 55-14-30(2)(ii) (2015); N.D. CENT. CODE § 10-19.1-115 (2015); OR. REV. STAT. § 60.661 (2015); 15 PA. CONS. STAT. ANN. § 1981 (West 2015); R.I. GEN. LAWS § 7-1.2-1314 (2015); S.C. CODE ANN. § 33-14-300 (2015); S.D. CODIFIED LAWS § 47-1A-1430 (2015); TENN. CODE ANN. § 48-24-301 (2015); UTAH CODE ANN. § 16-10a-1430 (West 2015); VT. STAT. ANN. tit. 11A, § 14.30 (2015); VA. CODE ANN. § 13.1-747 (2015); WASH. REV. CODE § 23B.14.300 (2015); W. VA. CODE § 31D-14-1430 (2015); WIS. STAT. § 180.1430 (2015); WYO. STAT. ANN. § 17-16-1430 (2015)).

³⁶⁷ *Id.* (citing GA. CODE ANN. § 14-2-940 (2015); MICH. COMP. LAWS § 450.1489 (2015); MINN. STAT. § 302A.751 (2015); N.J. STAT. ANN. § 14A:12-7 (West 2015); N.D. CENT. CODE § 10-19.1-115 (2015)).

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 387

by inferring lesser equitable powers³⁶⁸ as advocated by the *Ritchie* minority. Other courts, however, like the Texas Court in *Ritchie*, have limited remedies for “oppressive” conduct to those expressly authorized by statute.³⁶⁹ Notably, of the states that recognize oppression, the majority use the reasonable expectations test³⁷⁰ with a limited number using only the “burdensome, harsh . . . lack of . . . fair dealing . . . and a violation of fair play” test³⁷¹ or both tests.³⁷²

³⁶⁸ See, e.g., *Edenbaum v. Schwarcz-Osztreicherne*, 885 A.2d 365, 380 (Md. Ct. Spec. App. 2005) (“While [the Maryland statute] only mentions dissolution as a remedy for oppressive conduct, we join other courts today ‘which have interpreted their similar statutory counterparts to allow alternative equitable remedies not specifically stated in the statute.’” (quoting *Balvik v. Sylvester*, 411 N.W.2d 383, 388 (N.D. 1987))).

³⁶⁹ See, e.g., *Jordan v. Bowman Apple Prods., Co.*, 728 F. Supp. 409, 415 (W.D. Va. 1990) (rehabilitative receivership statute “supersedes the common law right of action for oppression and limits a plaintiff’s remedies to those available under the statute”); *Gianotti v. Hamway*, 387 S.E.2d 725, 733 (Va. 1990) (“The remedy specified by the legislature . . . is ‘exclusive,’ and does not permit the trial court to fashion other, apparently equitable remedies.”); cf. *Franchino v. Franchino*, 687 N.W.2d 620, 630 (Mich. Ct. App. 2004) (rejecting the reasonable-expectations test because it lacked statutory support).

³⁷⁰ See *Brooks v. Hill*, 717 So. 2d 759, 765–66 (Ala. 1998); *Stefano v. Coppock*, 705 P.2d 443, 446 n.3 (Alaska 1985); *Taylor v. Hinkle*, 200 S.W.3d 387, 393 (Ark. 2004); *McCann v. McCann*, 275 P.3d 824, 834 (Idaho 2012); *Baur v. Baur Farms, Inc.*, 832 N.W.2d 663, 673–74 (Iowa 2013); *Edenbaum*, 885 A.2d at 377–80; *Brodie v. Jordan*, 857 N.E.2d 1076, 1079 (Mass. 2006); *U.S. Bank N.A. v. Cold Spring Granite Co.*, 802 N.W.2d 363, 378–79 & n.10 (Minn. 2011); *Brenner v. Berkowitz*, 634 A.2d 1019, 1028 (N.J. 1993); *In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1179 (N.Y. 1984); *Meiselman v. Meiselman*, 307 S.E.2d 551, 563 (N.C. 1983); *Kortum v. Johnson*, 755 N.W.2d 432, 442 (N.D. 2008); *Ford v. Ford*, 878 A.2d 894, 904 (Pa. Super. Ct. 2005); *Landstrom v. Shaver*, 561 N.W.2d 1, 7–8 (S.D. 1997); *McLaughlin v. Schenck*, 220 P.3d 146, 157 (Utah 2009); *Woods v. Metzler*, No. 302-6-06, 2009 Vt. Super. LEXIS 29, at *9 (Vt. Sup. Ct. Feb. 13, 2009); see also 805 ILL. COMP. STAT. 5/12.56(D).

³⁷¹ See *Kisner v. Coffey*, 418 So. 2d 58, 61 (Miss. 1982); *Waters v. G&B Feeds, Inc.*, 306 S.W.3d 138, 147 (Mo. Ct. App. 2010); *Baker v. Commercial Body Builders, Inc.*, 507 P.2d 387, 393 (Or. 1973); *Kiriakides v. Atlas Food Sys. & Servs, Inc.*, 541 S.E.2d 257, 266 (S.C. 2001).

³⁷² See *Colt v. Mt. Princeton Trout Club, Inc.*, 78 P.3d 1115, 1119 (Colo. App. 2003); *Johnson v. Gibbs Wire & Steel Co.*, No. X05CV095013295S, 2011 Conn. Super. LEXIS 1369, at *23 (Conn. Super. Ct. May 31, 2011); *Napp v. Parks Camp, Ltd.*, 932 A.2d 531, 538 (Me. 2007); *Whitehorn v. Whitehorn Farms, Inc.*, 195 P.3d 836, 841–42 (Mont. 2008); *McCauley v. Tom McCauley & Son, Inc.*, 724 P.2d 232, 236 (N.M. Ct. App. 1986); *Hendrick v. Hendrick*, 755 A.2d 784, 791 (R.I. 2000); *Cochran v. L.V.R. & R.C., Inc.*, No. M2004-01382, 2005 Tenn. App. LEXIS 581, at *16 (Tenn. Ct. App. Sept. 12, 2005); *N. Air Servs. v. Link*, 804 N.W.2d 458, 475 n.32 (Wis. 2011).

Delaware has resisted the movement toward a special set of rules applicable only to closely held corporations, and has emphasized the need for minority investors to protect their interests through shareholder agreements.³⁷³ The Delaware Supreme Court explained:

The tools of good corporate practice are designed to give a purchasing minority stockholder the opportunity to bargain for protection before parting with consideration. It would do violence to normal corporate practice and our corporation law to fashion an ad hoc ruling which would result in a court-imposed stockholder buy-out for which the parties had not contracted.³⁷⁴

The court therefore rejected “special, judicially-created rules, to ‘protect’ minority stockholders of closely-held Delaware corporations.”³⁷⁵ Like the Texas Supreme Court, Delaware favors shareholder agreements as an alternative to imposing special duties.

The dissent in *Ritchie* characterizes the Court’s ruling as a “radical departure from settled precedents and expectations.”³⁷⁶ Other aspects of Texas law, however, have already made Texas distinct, and *Ritchie* merely brings Texas oppression law in line with those other doctrines. As discussed above, Texas does not recognize a formal fiduciary duty between shareholders of a close corporation³⁷⁷ or a general duty of good faith and fair dealing in contractual relationships.³⁷⁸ Most other jurisdictions

³⁷³ See *Nixon v. Blackwell*, 626 A.2d 1366, 1380–81 (Del. 1993).

³⁷⁴ *Id.* at 1380.

³⁷⁵ *Id.* at 1379, 1381. One unpublished Delaware opinion, relying primarily on New York law, declined to dismiss at the pleading stage a claim for “oppression” arising from a majority’s refusal to issue a dividend, which allegedly caused the plaintiff an “oppressive tax burden.” *Litle v. Waters*, No. 12155, 1992 Del. Ch. LEXIS 25, at *18, *25 (Del. Ch. Feb. 10, 1992). The *Litle* opinion, however, has been construed very narrowly by subsequent courts, in light of the Delaware Supreme Court’s holdings in *Nixon*. See, e.g., *Blaustein v. Lord Balt. Capital Corp.*, No. 6685-VCN, 2013 Del. Ch. LEXIS 108, at *53 & n.94 (Del. Ch. Apr. 30, 2013); *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 37–38 (Del. Ch. 2010); *Garza v. TV Answer, Inc.*, No. 12784, 1993 Del. Ch. LEXIS 40, at *19 (Del. Ch. Mar. 11, 1993).

³⁷⁶ *Ritchie v. Rupe*, 443 S.W.3d 856, 893 (Tex. 2014) (Guzman, J. dissenting).

³⁷⁷ See *supra* Part I.C.

³⁷⁸ *Formosa Plastics Corp. USA v. Presidio Eng’rs & Contractors, Inc.*, 960 S.W.2d 41, 52 (Tex. 1998) (“There is no general duty of good faith and fair dealing in ordinary, arms-length commercial transactions.”) (citing *English v. Fischer*, 660 S.W.2d 521, 522 (Tex. 1983)); *Subaru*

recognize one or both of these duties.³⁷⁹ On the other hand, Delaware law—often cited by the Texas Supreme Court for its corporate law jurisprudence³⁸⁰—“does not recognize that a majority stockholder has a special fiduciary duty to minority stockholders Delaware courts have declined to follow other jurisdictions which have adopted such a doctrine.”³⁸¹

Simply put, it would not be intellectually consistent for Texas to recognize shareholder oppression as a claim while not recognizing the claims that other jurisdictions have used to create or inform their state’s version of shareholder oppression. *Ritchie* righted the ship and aligned Texas with states like Delaware in affording broad protection for the judgment of majority shareholders.

VI. PROSPECTS FOR THE FUTURE

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.”³⁸² Those protections include: (1) statutory actions to access the

of *Am., Inc. v. David McDavid Nissan, Inc.*, 84 S.W.3d 212, 225 (Tex. 2002) (“A common-law duty of good faith and fair dealing does not exist in all contractual relationships . . . [r]ather, the duty arises only when a contract creates or governs a special relationship between the parties.”) (citing *Arnold v. Nat’l Cnty. Mut. Fire Ins. Co.*, 725 S.W.2d 165, 167 (Tex. 1987)). Texas does recognize duties of good faith and fair dealing in limited circumstances, including sales of goods governed by the UCC, TEX. BUS. & COM. CODE ANN. § 1.201(20), and in the insurance context, *Arnold*, 725 S.W.2d at 167. Nevertheless, Texas’s decision not to recognize a common-law duty of good faith and fair dealing again places Texas in the minority.

³⁷⁹ See, e.g., *McCauley v. Tom McCauley & Son, Inc.*, 724 P.2d 232, 236 (N.M. Ct. App. 1986) (discussing oppression in the context of “duty of good faith and fair dealing owed by the majority to minority”); *Baker v. Commercial Body Builders, Inc.*, 507 P.2d 387, 394 (Or. 1973) (“We agree, however, that the question of what is ‘oppressive’ conduct by those in control of a ‘close’ corporation as its majority stockholders is closely related to what we agree to be the fiduciary duty of a good faith and fair dealing owed by them to its minority stockholders.”).

³⁸⁰ See, e.g., *Grant Thornton L.L.P. v. Prospect High Income Fund*, 314 S.W.3d 913, 927 n.19 (Tex. 2010); *In re Schmitz*, 285 S.W.3d 451, 457 n.32 (Tex. 2009).

³⁸¹ *Blaustein v. Lord Balt Capital Corp.*, No. 6685-VCN, 2013 Del. Ch. LEXIS 108, at *58 (Del. Ch. Apr. 30, 2013) (citing *Riblet Prods. Corp. v. Nagy*, 683 A.2d 37, 39 (Del. 1996)); see also *Hollis v. Hill*, 232 F.3d 460, 473 (5th Cir. 2000) (Jolly, J., dissenting) (Delaware “clearly prohibits a cause of action for oppression of minority shareholders”).

³⁸² *Ritchie v. Rupe*, 443 S.W.3d 856, 882 (Tex. 2014).

entity's books and records; (2) derivative actions for breach of duty to the entity; (3) direct actions for breach of fiduciary duty to the individual arising from a confidential relationship; (4) statutory actions for receivership or liquidation; (5) breach of contract; (6) fraud; (7) conversion; and (8) unjust enrichment and quantum meruit.³⁸³ But, as discussed below, these existing causes of action may not provide full protection for a minority shareholder in all circumstances. Prudent investors, therefore, should protect themselves through timely organizational planning, shareholder agreements, and employment agreements.

Before separately discussing each of these alternatives, it is worth noting that claims of shareholder oppression have often been redundant or duplicative of other claims. For example, *In re Mandel* involved claims arising out of the organization, management, and operation of a short-lived, closely held software company, White Nile Software, Inc.³⁸⁴ After prolonged litigation in several courts culminating in a trial on disputed claims in bankruptcy court, the court found that Thrasher, a former business associate, "should prevail on his claims against Mandel for breach of contract, fraud, conspiracy, and shareholder oppression," as well as "misappropriation or theft of trade secrets,"³⁸⁵ and awarded \$1 million as compensatory damages on all such claims.³⁸⁶ The finding of shareholder oppression added nothing to the judgment. Likewise, in *Rosenbaum*, a key element of the plaintiff's claim was that he was fraudulently induced into investing, and the remedy was to order a refund of his investment.³⁸⁷ In these cases and others, the complaining shareholders could have prevailed on their claims even without asserting shareholder oppression.

³⁸³ *See id.*

³⁸⁴ No. 10-40219, 2011 Bankr. LEXIS 3829 (Bankr. E.D. Tex. Sept. 30, 2011), *aff'd in part and remanded*, Mandel v. Thrasher (*In re Mandel*), 578 F. App'x 376 (5th Cir. 2014).

³⁸⁵ *Id.* at *35, 44. Thrasher asserted claims "on his own behalf and derivatively on behalf of White Nile." *Id.* at *1.

³⁸⁶ *Id.* at *76. The Fifth Circuit affirmed the finding of oppressive conduct based on the definition articulated in *Ritchie*, but held *Ritchie* precluded monetary damages on that claim. *In re Mandel*, 578 F. App'x at 387.

³⁸⁷ Gage v. Rosenbaum (*In re Rosenbaum*), No. 08-43029, 2010 Bankr. LEXIS 1509, at *26 (Bankr. E.D. Tex. May 7, 2010).

A. Causes of Action Available to Dissatisfied Shareholders

1. Access to Books and Records

Those alleging shareholder oppression often complain about the denial of access to the corporation's books and records. Texas statutes protect a corporate shareholder's right to examine corporate records and provide penalties for violations of that right.³⁸⁸ The *Ritchie* Court concluded that these "statutory rights and remedies adequately protect a minority shareholder's access to corporate records."³⁸⁹ And indeed, minority shareholders have successfully sued for access to books and records without the need for a "shareholder oppression" cause of action. In *Biolustré Inc. v. Hair Ventures LLC*, for example, the San Antonio Court of Appeals affirmed the trial court's grant of a writ of mandamus to give the plaintiff access to books and records and noted that "being on unfriendly terms with a company and an intention to communicate the information obtained during the inspection with other stockholders are not proper reasons for denying a shareholder the right to inspect a corporation's books and records."³⁹⁰

2. 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.³⁹¹ In many cases, the majority shareholder carries out the complained-of conduct in the role of an officer or director of the company, and with such roles come fiduciary duties. Corporate directors owe a fiduciary duty to the corporation, and "this duty includes the dedication of [their] uncorrupted business judgment for the sole benefit of the corporation."³⁹² Put differently, majority shareholders "are without

³⁸⁸ See TEX. BUS. ORGS. CODE ANN § 21.218 (examination of records); § 21.219 (annual and interim statements of corporation); § 21.222 (penalty for refusal to permit examination) (West 2013).

³⁸⁹ *Ritchie v. Rupe*, 443 S.W.3d 856, 882 (Tex. 2014).

³⁹⁰ No. 04-10-00360-CV, 2011 Tex. App. LEXIS 1084, at *10 (Tex. App.—San Antonio Feb. 16, 2011, no pet.).

³⁹¹ *Ritchie*, 443 S.W.3d at 881.

³⁹² *Id.* at 868 (citing *Int'l Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 577 (Tex. 1963)).

authority to act [as directors] in a matter in which [their] interest is adverse to that of the corporation.”³⁹³ So if the director is making decisions that benefit herself at the expense of the company, breach of fiduciary duty is an available cause of action. And while the business judgment rule provides directors some leeway, they are “duty-bound to exercise business judgment for the sole benefit of the corporation, and not for the benefit of individual shareholders.”³⁹⁴

But the majority shareholder/director generally owes these duties to the corporation, not to the individual shareholder, and damages for breach of such duty therefore are suffered by the corporation. Because a corporate shareholder has no cause of action for damages caused by a wrong done to the corporation, “to recover for wrongs done to the corporation, the shareholder must bring the suit derivatively in the name of the corporation so that each shareholder will be made whole if the corporation obtains compensation from the wrongdoer.”³⁹⁵

The Legislature has made it easier for shareholders in a closely held corporation to bring derivative actions in these situations by, for example, removing the “demand” requirement and the burden of proving that they fairly and adequately represent the interests of the corporation.³⁹⁶ Moreover, “[i]f justice requires,” a “derivative proceeding brought by a shareholder of a closely held corporation may be treated by a court as a direct action brought by the shareholder for the shareholder’s own benefit under certain circumstances and may award damages directly to the shareholder.”³⁹⁷ Although the claim may be “treated” as direct, that determination does “not mean that the action is no longer a derivative proceeding.”³⁹⁸ The claim

³⁹³ *Dunagan v. Bushey*, 263 S.W.2d 148, 152 (Tex. 1953).

³⁹⁴ *Ritchie*, 443 S.W.3d at 869.

³⁹⁵ *Webre v. Sneed*, 358 S.W.3d 322, 329–30 (Tex. App.—Houston [1st Dist.] 2011, pet. granted) (cause set for submission by order entered August 29, 2014).

³⁹⁶ TEX. BUS. ORGS. CODE ANN § 21.563(b) (West 2013). Under this statute, a “closely held corporation” is a corporation with fewer than thirty-five shareholders and that has no shares listed on a national securities exchange or regularly quoted in an over-the-counter market. *Id.* § 21.563(a).

³⁹⁷ *Id.* § 21.563(c)(1).

³⁹⁸ *Swank v. Cunningham*, 258 S.W.3d 647, 665 (Tex. App.—Eastland 2008, pet. denied).

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 393

must still be based on injuries to the corporation as opposed to the individual shareholders.³⁹⁹

One common act of “oppression” that may be remedied through a derivative action is a majority shareholder director using surplus funds to grant himself a bonus or raise or to pay excessive salaries to his family members, instead of declaring a dividend.⁴⁰⁰ Regarding this type of conduct, the Texas Supreme Court has reiterated that officers and directors are prohibited by the duty of loyalty from “misapplying corporate assets for their personal gain or wrongfully diverting corporate opportunities to themselves.”⁴⁰¹ Through a derivative claim for breach of fiduciary duty, a minority shareholder can reclaim those monies for the company, and will be benefitted by his share of the increased value.

The minority shareholder has the burden, however, to prove that the compensation received by the majority shareholder or his family members was excessive.⁴⁰² There is nothing wrong with hiring family members to work for the company, provided they are actually performing the jobs for which they are paid, the jobs are necessary to the corporation, and the compensation is reasonable.⁴⁰³ The reasonableness of compensation is generally a question of fact, and “each case turns on its own facts and circumstances.”⁴⁰⁴ In determining whether compensation is excessive, the court should consider factors such as:

- (1) the employee’s qualifications;
- (2) the nature, extent and scope of the employee’s work;
- (3) the size and complexities of the business;

³⁹⁹Guerra v. Guerra, No. 04-10-00271-CV, 2011 Tex. App. LEXIS 6730, at *16 (Tex. App.—San Antonio Aug. 24, 2011, no pet.).

⁴⁰⁰See *ARGO Data Res., Inc. v. Shagrithaya*, 380 S.W.3d 249, 268 (Tex. App.—Dallas 2012, pet denied); *Boehringer v. Konkel*, 404 S.W.3d 18, 31 (Tex. App.—Houston [1st Dist.] 2013, no pet.).

⁴⁰¹*Ritchie v. Rupe*, 443 S.W.3d 856, 887 (Tex. 2014).

⁴⁰²*Boehringer*, 404 S.W.3d at 31 (noting minority shareholder’s burden to demonstrate that majority shareholder “received compensation in excess to what was reasonable for his position and level of responsibility”).

⁴⁰³*Rivas v. Cantu*, 37 S.W.3d 101, 119 (Tex. App.—Corpus Christi 2000, pet. denied).

⁴⁰⁴*Gibney v. Culver*, No. 13-06-112-CV, 2008 WL 1822767, at *13 (Tex. App.—Corpus Christi Apr. 24, 2008, pet. denied) (citing *Rutter v. Comm’r of Internal Revenue*, 853 F.2d 1267, 1271 (5th Cir. 1988)).

- (4) a comparison of salaries paid with gross income and net income;
- (5) the prevailing general economic conditions;
- (6) comparison of salaries with distributions to stockholders;
- (7) the prevailing rates of compensation for comparable positions in comparable concerns;
- (8) the salary policy of the taxpayer [corporation] as to all employees; and
- (9) in the case of small corporations with a limited number of officers[,] the amount of compensation paid to a particular employee in previous years.⁴⁰⁵

Absent contrary evidence, the court will presume that salaries authorized by the board of directors are reasonable.⁴⁰⁶

The availability of derivative claims does not fully protect the minority shareholder's interests, especially when those interests do not align with those of the company. The Texas Supreme Court cautioned, for example, that if a "director's decision not to declare dividends is made for the benefit of the corporation, in compliance with the duties of care and loyalty, no relief is warranted."⁴⁰⁷ This is true even if the decisions "result in incidental harm to a minority shareholder's individual interests."⁴⁰⁸ The dissent in *Ritchie* argued that "typical acts of minority shareholder oppression . . . usually operate to benefit the corporation and hardly ever harm it."⁴⁰⁹ The majority disagreed, observing that, as in *Patton*, "[r]efusal to pay dividends, paying majority shareholders outside the dividend process, and making fire-sale buyout offers certainly can harm the corporation, for instance, by lowering the value of its stock."⁴¹⁰ As the majority observed, it is often the failure to declare dividends combined with some scheme to inflate the value

⁴⁰⁵ *Id.* (alterations in original).

⁴⁰⁶ *Id.* (citing *Mayson Mfg. Co. v. Comm'r of Internal Revenue*, 178 F.2d 115, 119 (6th Cir. 1949)).

⁴⁰⁷ *Ritchie v. Rupe*, 443 S.W.3d 856, 884 (Tex. 2014).

⁴⁰⁸ *Id.*

⁴⁰⁹ *Id.* at 893 (Guzman, J., dissenting).

⁴¹⁰ *Id.* at 885 n.53.

of the majority shareholder's own shares (or devalue the minority shareholder's shares) that is the source of an oppression claim.⁴¹¹

3. Breach of Fiduciary Duty to Individual Arising From Confidential Relationship

While derivative claims might adequately address harm to the corporation, they generally cannot address injury suffered only by the minority shareholder. The minority shareholder can bring a direct claim for breach of fiduciary duty only if the majority shareholder (or other person in control of the company) owes a fiduciary duty to the minority. As discussed above, the Texas Supreme Court has never recognized a formal fiduciary duty between majority and minority shareholders in a closely held corporation and expressly declined to do so in *Ritchie*.⁴¹²

Texas does, however, recognize “an informal fiduciary duty that arises from a moral, social, domestic or purely personal relationship of trust and confidence.”⁴¹³ But a person “is justified in placing confidence in the belief that another party will act in his best interest only when he is accustomed to being guided by the other party’s judgment or advice.”⁴¹⁴ In the business transaction context that “special relationship of trust and confidence must exist prior to, and apart from, the agreement made the basis of the suit.”⁴¹⁵

In many instances of alleged minority shareholder oppression, the shareholders are merely business partners or coworkers who were engaged in business successfully until their relationship deteriorated and a lawsuit was filed.⁴¹⁶ In such instances, no informal fiduciary duty will generally exist because the trust and confidence does not exist separate and apart from

⁴¹¹ *Id.* at 885.

⁴¹² *Id.* at 890 & n.62. *See supra* Part IV.A (describing basis for fiduciary duty claim in *Ritchie*, which may be addressed on remand by the court of appeals).

⁴¹³ *Meyer v. Cathey*, 167 S.W.3d 327, 331 (Tex. 2005) (internal quotation marks omitted).

⁴¹⁴ *Kilpatrick v. Kilpatrick*, No. 02-12-00206-CV, 2013 Tex. App. LEXIS 9189, at *11–12 (Tex. App.—Fort Worth July 25, 2013, pet. denied) (mem. op.).

⁴¹⁵ *Meyer*, 167 S.W.3d at 331 (citing *Associated Indem. Corp. v. CAT Contracting, Inc.*, 964 S.W.2d 276, 288 (Tex. 1998)).

⁴¹⁶ *See, e.g., Kilpatrick*, 2013 Tex. App. LEXIS 9189 at *1–3; *ARGO Data Res., Inc. v. Shagrithaya*, 380 S.W.3d 258–59 (Tex. App.—Dallas 2012, pet. denied).

the business relationship. Mere subjective trust, even between family members, is insufficient to establish an informal fiduciary duty.⁴¹⁷

Some courts have suggested, however, that an informal fiduciary duty can arise between majority and minority shareholders when the majority “dominates control over the business.”⁴¹⁸ The genesis of this position can be traced to a footnote in *Hoggett v. Brown*.⁴¹⁹ The appellate court in that case held no fiduciary duty was owed, because, *inter alia*, “a co-shareholder in a closely held corporation does not as a matter of law owe a fiduciary duty to his co-shareholder.”⁴²⁰ The court further explained that “whether such a duty exists depends on the circumstances. For example, if a confidential relationship exists.”⁴²¹ It then suggested in *dicta* that “in certain limited circumstances, a majority shareholder who dominates control over the business *may* owe such a duty to the minority shareholder.”⁴²² Neither *Hoggett* nor the cases it cites in note 13 define the “certain limited circumstances” or the scope of the duty that “may” be owed. Nor do they explain the difference between a majority shareholder exercising the rights inherent in majority ownership and “dominating control” of the company. Nevertheless, this language has been picked up by plaintiffs and some courts as grounds for either a “formal” or an “informal” fiduciary duty owed to minority shareholders.⁴²³ This position has no legs after *Ritchie*.

⁴¹⁷ See *Kilpatrick*, 2013 Tex. App. LEXIS 9189 at *16 (holding “mere subjective trust alone does not establish a fiduciary relationship” in ruling against minority shareholder whose brothers, the majority shareholders, and mother convinced him to sell his shares, causing the minority shareholder to lose out on a large business opportunity).

⁴¹⁸ *Hoggett v. Brown*, 971 S.W.2d 472, 488 n.13 (Tex. App.—Houston [14th Dist.] 1997, pet. denied).

⁴¹⁹ *Id.*

⁴²⁰ *Id.* at 488 (citing *Kaspar v. Thorne*, 755 S.W.2d 151, 155 (Tex. App.—Dallas 1988, no writ); *Schoellkopf v. Pledger*, 739 S.W.2d 914 (Tex. App.—Dallas 1987), *rev’d on other grounds*, 762 S.W.2d 145, 155 (Tex. 1988)).

⁴²¹ *Id.* (internal citations omitted).

⁴²² *Id.* at 488 n.13 (emphasis added) (citing *Patton v. Nicholas*, 279 S.W.2d 848, 853 (Tex. 1955); *Davis v. Sheerin*, 754 S.W.2d 375, 383 (Tex. App.—Houston [1st Dist.] 1988, writ denied); *Duncan v. Lichtenberger*, 671 S.W.2d 948, 953 (Tex. App.—Fort Worth 1984, writ ref’d n.r.e.); *Thompson v. Hambrick*, 508 S.W.2d 949, 954 (Tex. Civ. App.—Dallas 1974, writ ref’d n.r.e.); *Morrison v. St. Anthony Hotel*, 295 S.W.2d 246 (Tex. Civ. App.—San Antonio 1956, writ ref’d n.r.e.)).

⁴²³ See, e.g., *Gage v. Rosenbaum*, No. 08-43029, 2010 Bankr. LEXIS 1509, at *21 (Bankr. E.D. Tex. May 7, 2010) (citing *Hoggett v. Brown*, 971 S.W.2d 472, 488 n.13 (Tex. App.—Houston [14th Dist.] 1997, pet. denied), finding defendants owed minority shareholder a fiduciary

The dissent in *Ritchie* characterized the *Patton* decision as tacitly recognizing an informal fiduciary duty between majority and minority owners and argued that Texas appellate courts properly determined the existence of such a duty on a “case-by-case basis.”⁴²⁴ The dissent also argued the Court ought not apply the business judgment rule in the informal fiduciary duty context, to avoid further weakening this avenue for recovery.⁴²⁵ The Court seemed to agree, observing that the “Court has never applied the business judgment rule to informal fiduciary duties before; no party argues that we should do so in this case; and because such duties arise separate and apart from business relationships, we see no reason to assume that the rule would apply.”⁴²⁶ Even without the business judgment rule, it will be the rare minority shareholder that can establish an informal fiduciary duty with the majority shareholder.

4. Statutory Action for Receivership or Liquidation

As discussed above, the Texas Business Organizations Code allows minority shareholders to petition courts to appoint a receiver to rehabilitate a domestic corporation under certain circumstances, including but not limited to where the shareholder establishes that “the actions of the governing persons of the entity are illegal, oppressive, or fraudulent.”⁴²⁷ In addition to limiting the remedies available under this statute to those

duty because they “dominated control” of the company); *Cotten v. Weatherford Bancshares, Inc.*, 187 S.W.3d 687, 699 (Tex. App.—Fort Worth 2006, pet. denied) (commenting that “majority shareholders are sometimes said to stand in a fiduciary relationship with both the corporation that they control and with the minority shareholders”). The Dallas Court of Appeals in *Cardiac Perfusion* rejected Hughes’s cross-appeal argument that he was owed a formal fiduciary duty “by virtue of Joubran’s status as a majority shareholder dominating control over CPS.” *Cardiac Perfusion Servs., Inc. v. Hughes*, 380 S.W.3d 198, 213 (Tex. App.—Dallas 2012). The trial court in *Ritchie* instructed the jury that a fiduciary duty arises when “the majority shareholder dominates control over the business.” Respondent’s Brief on the Merits at 35–36, *Ritchie v. Rupe*, 443 S.W.3d 856 (Tex. 2014) (No. 11-0447).

⁴²⁴ *Ritchie v. Rupe*, 443 S.W.3d 856, 906–07 (Tex. 2014) (Guzman, J., dissenting) (“When we recognized a claim for breach of fiduciary duty in *Patton*, the majority shareholder was harming the minority shareholders but not the corporation itself, and we compelled a dividend to be paid to the minority shareholders.”).

⁴²⁵ *Id.* at 903.

⁴²⁶ *Id.* at 874 n.27.

⁴²⁷ TEX. BUS. ORGS. CODE ANN. § 11.404(a)(1)(C) (West 2012).

expressly authorized under the statute,⁴²⁸ the *Ritchie* Court also gave more guidance on the meaning of “oppressive” acts.⁴²⁹ By limiting the definition of “oppressive” acts to those that create a serious risk of harm to the corporation, the *Ritchie* Court clarified that minority shareholders have no recourse under the statute for harm they suffer individually.

A separate statute authorizes appointment of a receiver to liquidate a corporation in extreme situations. However, that statute narrowly defines the circumstances in which liquidation is appropriate to cases: (1) where the entity itself requests court-supervised liquidation; (2) where the entity is already in receivership and the receiver has not developed a feasible plan after a year; (3) where a creditor alleges that irreparable damages will ensue to the unsecured creditors absent liquidation; and certain cases (4) brought by the attorney general; or (5) involving non-profit entities.⁴³⁰ Even where one of the above criteria is met, the party seeking liquidation must demonstrate that “the circumstances demand liquidation to avoid damage to interested persons,” “all other requirements of law are complied with,” and all other available remedies are inadequate.⁴³¹

5. Breach of Contract

In *Ritchie*, the Court acknowledged that the majority’s refusal to meet with prospective buyers “placed Rupe in a difficult situation” but concluded their refusal was not “oppressive” under the receivership statute.⁴³² The Court regarded this difficult situation as an inherent risk of ownership of shares in a closely held corporation. The Court also noted that minority shareholders “may address and resolve such difficulties by entering into shareholder agreements that contain buy-sell, first refusal, or redemption provisions that reflect their mutual expectations and agreements.”⁴³³ Some excessive compensation claims, for example, arise from a compensation

⁴²⁸ *Ritchie*, 443 S.W.3d at 872 (noting “[f]ormer article 7.05 creates a single cause of action with a single remedy: an action for appointment of a rehabilitative receiver”).

⁴²⁹ *Id.* at 870.

⁴³⁰ TEX. BUS. ORGS. CODE ANN. § 11.405(a) (West 2012).

⁴³¹ *Id.* § 11.405(b).

⁴³² *Ritchie*, 443 S.W.3d at 871.

⁴³³ *Id.* See also *infra*, discussion on shareholder agreements in Parts VI.A.5 and VI.B.

provision in a partnership agreement or shareholder agreement.⁴³⁴ The demand for dividends in *Kohannim v. Katoli* relied on a provision in the company's bylaws requiring distribution of "available cash."⁴³⁵ The buy-sell agreement in *Cardiac Perfusion* was ultimately held enforceable by the Texas Supreme Court⁴³⁶ and a similar agreement would have resolved the dispute in *Four Seasons* if the majority shareholders had properly invoked its provisions.⁴³⁷

An action for breach of contract requires the plaintiff to prove: (1) the existence of a valid contract; (2) the plaintiff performed or tendered performance; (3) the defendant breached the contract; and (4) the defendant's breach caused the plaintiff injury.⁴³⁸ Minority shareholders face several hurdles in pursuing claims for breach of contract.

The first obstacle for many shareholders is proving a contract. It is often the case that there is no express written or oral contract between the minority shareholder, on the one hand, and either the corporation or the majority shareholder, on the other. In the absence of an express contract, 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.⁴³⁹ But the "parties must assent to the same thing in the same sense at the same time" and "[t]heir assent must comprehend the whole proposition, and the agreement must comprise all of the terms that they intend to introduce into it."⁴⁴⁰

⁴³⁴ See, e.g., *Fish v. Tex. Legislative Serv., P'ship*, No. 03-10-00358-CV, 2012 Tex. App. LEXIS 749, at *15 (Tex. App.—Austin Jan. 27, 2012, no pet.).

⁴³⁵ *Kohannim v. Katoli*, 440 S.W.3d 798, 813 (Tex. App.—El Paso 2013, pet. denied); see also *Morrison v. St. Anthony Hotel*, 295 S.W.2d 246, 250 (Tex. Civ. App.—San Antonio 1956, writ ref'd n.r.e.).

⁴³⁶ *Cardiac Perfusion Servs., Inc. v. Hughes*, 436 S.W.3d 790, 793 (Tex. 2014) (reversing the trial court's "denial of Joubran's and CPS's request for declaratory judgment" on the agreement).

⁴³⁷ See *In re White*, 429 B.R. 201, 211–12, 217 (Bankr. S.D. Tex. 2010); see *supra* note 209 and accompanying text.

⁴³⁸ See *Marquis Acquisitions, Inc. v. Steadfast Ins. Co.*, 409 S.W.3d 808, 813 (Tex. App.—Dallas 2013, no pet.).

⁴³⁹ *Haws & Garrett Gen. Contractors, Inc. v. Gorbett Bros. Welding Co.*, 480 S.W.2d 607, 609 (Tex. 1972).

⁴⁴⁰ *ARGO Data Res. Corp. v. Shagrithaya*, 380 S.W.3d 249, 274 (Tex. App.—Dallas 2012, pet denied) (finding no enforceable agreement where minority shareholder had no discussions

Another obstacle may be determining whether the alleged contract is with the majority shareholder or the corporation. A majority shareholder who is not a party to the contract:

may not be held liable to the corporation or its obligees with respect to . . . any contractual obligation of the corporation . . . on the basis that the holder . . . is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory.⁴⁴¹

The exception to that liability limit is if the obligee demonstrates the majority shareholder used the corporation to perpetrate a fraud.⁴⁴²

As more shareholders try to protect themselves through shareholder agreements,⁴⁴³ company agreements, and other written contracts, breach of contract claims may become the tool of choice for disgruntled minority shareholders.

6. Fraud

Before turning to common law fraud, we note that fraudulent conduct is one of the grounds entitling a party to relief under the receivership statute, discussed above. But, also as discussed above, the relief under that statute is limited, whereas a common-law claim for fraud allows for more diverse equitable remedies, and even punitive damages.

The elements of a common law fraud claim are: (1) the defendant made a representation to the plaintiff; (2) the representation was material; (3) the representation was false; (4) the defendant made the representation either knowing it was false or recklessly without knowledge of its truth; (5) the defendant made the representation with the intent that the plaintiff act on it; (6) the plaintiff justifiably relied on the representation; and (7) reliance on

with majority about compensation and the sole basis of the claim was a history of the majority and minority receiving equal compensation).

⁴⁴¹Willis v. Donnelly, 199 S.W.3d 262, 272 (Tex. 2006) (citing TEX. BUS. ORGS. CODE ANN. § 21.223(a) (West 2003) (alteration in original)).

⁴⁴²TEX. BUS. ORGS. CODE ANN. § 21.223(b) (West 2012).

⁴⁴³See *infra* Part VI.B for a discussion of shareholder agreements.

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 401

the representation caused the plaintiff injury.⁴⁴⁴ Claims for fraud sometimes mask more specific claims such as corporate mismanagement or the failure to grant dividends.⁴⁴⁵

In the close corporation context, the alleged representation is often one regarding future performance, such as the frequency of dividend payments or continued employment. But false promises of future performance constitute actionable misrepresentations only “if the promise was made with no intention of performing at the time it was made.”⁴⁴⁶ Proving that a majority shareholder had no intention of performing when a statement was made “is not easy, as intent to defraud is not usually susceptible to direct proof.”⁴⁴⁷ However, Texas courts have found that a breach of contract “combined with slight circumstantial evidence of fraud is some evidence of fraudulent intent, enough to support a verdict.”⁴⁴⁸ *Rivas v. Cantu*, for example, involved two people who agreed to start an adult day-care business together and originally agreed to be 50/50 owners in the company.⁴⁴⁹ After Cantu performed the preliminary work of obtaining a Medicare license and remodeling a building to house the center, Rivas brought in two additional partners and reduced Cantu’s ownership percentage to 25%.⁴⁵⁰ The court held:

Rivas’s intent not to perform the representations he made to Cantu can be inferred from his subsequent actions:
(1) forcing two more partners on Cantu at the last minute,
(2) refusing to vote that Cantu be paid the promised salary,
(3) forcing Cantu out of the business, (4) refusing to see that the stock certificates were issued upon Cantu’s request,

⁴⁴⁴*Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am.*, 341 S.W.3d 323, 337 (Tex. 2011).

⁴⁴⁵*Patton v. Nicholas*, 279 S.W.2d 848, 853 (Tex. 1955) (finding minority shareholders’ “real complaint is less that the petitioner misrepresented his true state of mind, than that he later and wrongfully suppressed dividends or mismanaged the corporation or both”).

⁴⁴⁶*Aquaplex, Inc. v. Rancho La Valencia, Inc.*, 297 S.W.3d 768, 774 (Tex. 2009) (quoting *Formosa Plastics Corp. USA v. Presidio Eng’rs & Contractors, Inc.*, 960 S.W.2d 41, 48 (Tex. 1998)).

⁴⁴⁷*Id.* at 774–75 (quoting *Tony Gallo Motors I, L.P. v. Chapa*, 212 S.W.3d 299, 305 (Tex. 2006)).

⁴⁴⁸*Id.* at 775 (internal quotation marks omitted).

⁴⁴⁹37 S.W.3d 101, 118 (Tex. App.—Corpus Christi 2000, pet. denied).

⁴⁵⁰*Id.*

and (5) refusing to meet with Cantu when requested to do so.⁴⁵¹

For the fifth element, in addition to proving that the defendant intended the plaintiff to rely on the representation, the plaintiff must show that he suffered pecuniary loss “in the type of transaction in which [the defendant] intends or has reason to expect [plaintiff’s] conduct to be influenced.”⁴⁵² In *Exxon*, the Texas Supreme Court described the intent-to-induce-reliance element of fraud as “a focused inquiry, more akin to a rifle shot than a shotgun blast.”⁴⁵³ Moreover, “the claimant’s reliance must be especially likely and justifiable, and the transaction sued upon must be the type the defendant contemplated.”⁴⁵⁴ Simply put, the representation and the misconduct have to match; a representation regarding, for instance, continued employment in the company would be insufficient if the minority’s injury resulted from an alleged failure to pay dividends.

The plaintiff must also prove actual and justifiable reliance.⁴⁵⁵ For simple fraud, actual reliance is merely knowing of a representation and acting on it.⁴⁵⁶ For fraudulent inducement claims, the plaintiff is required to prove that he entered into a binding contract based on the representation.⁴⁵⁷ And while a plaintiff’s reliance must be justifiable, the plaintiff does not typically have a duty to investigate.⁴⁵⁸

Finally, the plaintiff must demonstrate that reliance on the representation caused the plaintiff an injury or that the plaintiff relied to the plaintiff’s detriment.⁴⁵⁹ This is far from straightforward for a minority

⁴⁵¹ *Id.*; see also *Gage v. Rosenbaum*, No. 08-43029, 2010 Bankr. LEXIS 1509, at *26–27 (Bankr. E.D. Tex. May 7, 2010).

⁴⁵² *Exxon Corp. v. Emerald Oil & Gas Co.*, 348 S.W.3d 194, 218–19 (Tex. 2011) (quoting RESTATEMENT (SECOND) OF TORTS § 531 (1977)).

⁴⁵³ *Id.* at 219.

⁴⁵⁴ *Ernst & Young, L.L.P. v. Pacific Mut. Life Ins.Co.*, 51 S.W.3d 573, 580 (Tex. 2001) (internal quotation marks omitted) (applying the reason-to-expect standard for fraud and holding that it is stricter than the foreseeability standard).

⁴⁵⁵ See *Cooper v. Cochran*, 288 S.W.3d 522, 532 (Tex. App.—Dallas 2009, no pet.) (transferring property to defendant after defendant made promises to plaintiff proved reliance).

⁴⁵⁶ *Id.*

⁴⁵⁷ *Haase v. Glazner*, 62 S.W.3d 795, 798 (Tex. 2001). The existence of a binding contract may allow a minority shareholder to pursue breach of contract claims. See *supra* Part VI.A.5.

⁴⁵⁸ *Koral Indus. v. Security-Conn. Life Ins. Co.*, 802 S.W.2d 650, 651 (Tex. 1990).

⁴⁵⁹ *Exxon Corp. v. Emerald Oil & Gas Co.*, 348 S.W.3d 194, 218–19 (Tex. 2011).

shareholder who might have difficulty proving he would have had the ability to improve his situation had he not been defrauded.⁴⁶⁰ In *ARGO*, for example, the minority's fraud claim was based "solely on [the majority shareholder's] failure to disclose his anticipation of buying out [the minority shareholder's] shares as the purpose for retaining [the company's] earnings from approximately 2001 to 2006."⁴⁶¹ The minority shareholder argued he was damaged by this conduct because, if the majority shareholder's true motives had been disclosed, he could have complained and the majority shareholder might have voted for a dividend.⁴⁶² The court held that it "cannot be presumed that [the majority] would have voted for a dividend" and that there was no evidence that, but for the majority's alleged misrepresentation, a dividend would have issued.⁴⁶³

In sum, while there are many elements to a fraud claim and the plaintiff's burden of proof is substantial, fraud is another potentially viable cause of action when the minority has been damaged by the majority's misrepresentations.

7. Unjust Enrichment and Quantum Meruit

The *Ritchie* Court also identified unjust enrichment and quantum meruit as potential causes of action available to minority shareholders.⁴⁶⁴ A plaintiff "may recover under the unjust enrichment theory when one person has obtained a benefit from another by fraud, duress, or the taking of an undue advantage."⁴⁶⁵ Where fraud is allegedly involved, a plaintiff may also have a cause of action for common law fraud as described above.⁴⁶⁶ This section will not discuss "duress" other than by noting it would be rare for a minority shareholder to invest in a company as a result of duress. Texas

⁴⁶⁰ See *ARGO Data Res. Corp. v. Shagrithaya*, 380 S.W.3d 249, 273 (Tex. App.—Dallas 2012, pet. denied).

⁴⁶¹ *Id.*

⁴⁶² *Id.*

⁴⁶³ *Id.*

⁴⁶⁴ *Ritchie v. Rupe*, 443 S.W.3d 856, 882 (Tex. 2014).

⁴⁶⁵ *Heldenfels Bros. v. City of Corpus Christi*, 832 S.W.2d 39, 41 (Tex. 1992); see *Mowbray v. Avery*, 76 S.W.3d 663, 679 (Tex. App.—Corpus Christi 2002, pet. denied).

⁴⁶⁶ *Heldenfels*, 832 S.W.2d at 41.

courts have interpreted taking an undue advantage as receiving a benefit one hasn't paid for or earned.⁴⁶⁷

While unjust enrichment may be an available theory for some minority shareholders, others may have a difficult time proving benefits received by the company or the majority shareholder are the result of the taking of an undue advantage. Majority shareholders make substantial investments in, and usually perform essential functions for, the company. If the company flounders, the majority typically receives few benefits. And if the company succeeds, it is often as a result of the majority's stewardship and hard work. A plaintiff cannot establish unjust enrichment merely because it "might appear expedient or generally fair that some recompense be afforded for an unfortunate loss."⁴⁶⁸

Quantum meruit is a species of unjust enrichment, available when the claimant has not been compensated for valuable services.⁴⁶⁹ To recover under quantum meruit, a plaintiff must prove:

- (1) valuable services were rendered or materials furnished;
- (2) for the person sought to be charged;
- (3) which services and materials were accepted by the person sought to be charged, used and enjoyed by him;
- (4) under such circumstances as reasonably notified the person sought to be charged that the plaintiff in performing such services was expecting to be paid by the person sought to be charged.⁴⁷⁰

Such a claim might arise when a minority shareholder works for the company without an employment agreement.⁴⁷¹ In such instances, the shareholders might agree to delay drawing a salary until the firm becomes profitable, investing "sweat equity" in the venture. Once the company becomes profitable, the majority shareholder or company management

⁴⁶⁷ See, e.g., *RDG Ltd. P'ship v. Gexa Corp.*, No. 14-04-00679-CV, 2005 Tex. App. LEXIS 3123, at *13 (Tex. App.—Houston [14th Dist.] April 26, 2005, no pet.) (affirming trial court determination that electricity supplier was entitled to restitution from company that received several months of free electricity from supplier).

⁴⁶⁸ *Heldenfels*, 832 S.W.2d at 42.

⁴⁶⁹ *Vortt Exploration Co. v. Chevron U.S.A., Inc.*, 787 S.W.2d 942, 944 (Tex. 1990).

⁴⁷⁰ *Id.*

⁴⁷¹ See, e.g., *ARGO Data Res. Corp. v. Shagrithaya*, 380 S.W.3d 249, 258 (Tex. App.—Dallas 2012, pet. denied).

could refuse to let the company pay the minority shareholder for work performed. In these circumstances, the minority shareholder has a potential claim against the company for quantum meruit: the minority performed services for the company, the company enjoyed the benefit of those services, and arguably had notice that the minority shareholder expected to be paid for them. This cause of action has the advantage of allowing the shareholder to recover individually, rather than derivatively. But it allows recovery only of the value of the services rendered, not for unpaid dividends or the value of the minority shareholder's stock.

B. Organizational Planning and Shareholder Agreements Are More Important Than Ever

1. Shareholder Agreements or Other Written Contracts

In *Ritchie*, the Court observed that corporations and their owners have “broad freedom to dictate for themselves the rights, duties, and procedures that govern their relationship with each other and with the corporation” and that executing a contract to that effect may “prevent and resolve common disputes.”⁴⁷² In other words, the Court expects parties to memorialize their mutual expectations in written contracts.⁴⁷³ Although the *Ritchie* dissent and commentators note that “people enter closely-held businesses in the same manner as they enter marriage: optimistically and ill-prepared,”⁴⁷⁴ the Court placed responsibility on the parties to protect themselves and determine their own destinies by being practical and entering into shareholder agreements.⁴⁷⁵ One commentator has asked how far court involvement should extend once relationships sour:

[In the absence of shareholder agreements, disputes often] arise from a situation in which a stockholder finds that things have not turned out as well as expected, and that he or she has struck a bad bargain. Should the court relieve that party of the consequences of that bargain? The usual answer in the American legal system is no, unless the

⁴⁷²*Ritchie v. Rupe*, 443 S.W.3d 856, 881 (Tex. 2014).

⁴⁷³*See id.*

⁴⁷⁴Charles W. Murdock, *The Evolution of Effective Remedies for Minority Shareholders and Its Impact Upon Valuation of Minority Shares*, 65 NOTRE DAME L. REV. 425, 426 (1990).

⁴⁷⁵*Ritchie*, 443 S.W.3d at 881.

complaining party can prove fraud, duress, or unconscionability. . . . It is hard to argue, in any event, that business investors should be held to a lower standard of rational behavior than other contracting parties.⁴⁷⁶

The Texas Legislature has also acknowledged the value of shareholder agreements in closely held corporations.⁴⁷⁷ Section 21.101 of the Texas Business Organizations Code provides that a shareholder agreement can: (1) restrict the discretion or powers of the board of directors, identify directors and officers, or eliminate the board altogether; (2) govern the authorization or making of distributions; (3) establish terms of employment or provision of services; (4) authorize arbitration or other procedures to resolve deadlock; or (5) otherwise govern the relationship among the shareholders, the directors, and the corporation.⁴⁷⁸ And provisions in a shareholder agreement are effective even when inconsistent with the Texas Business Organizations Code.⁴⁷⁹ Pursuant to these sections, shareholder agreements could be structured to address much of the conduct minority shareholders often complain of.⁴⁸⁰ For instance, a shareholder agreement can mandate periodic dividends or include buyout provisions or the right of first refusal to facilitate the minority shareholder in recouping his investment.

However, the code clarifies that “[t]he existence of or a performance under a shareholders’ agreement . . . is not a ground for imposing personal liability on a shareholder for an act or obligation of the corporation by disregarding the separate existence of the corporation.”⁴⁸¹ This is true even when the shareholder agreement treats the corporation as if it were a partnership or results in a failure to observe the corporate formalities

⁴⁷⁶Dalley, *supra* note 218 at 205; *see also* Sandra K. Miller, *What Fiduciary Duties Should Apply to the LLC Manager After More Than a Decade of Experimentation?*, 32 J. CORP. L. 565, 569–70, 592 (2007) (highlighting importance of written agreements in defining respective rights and obligations of parties to business relationships).

⁴⁷⁷*See* TEX. BUS. ORGS. CODE ANN. §§ 21.101–.110 (West 2012).

⁴⁷⁸*Id.* § 21.101.

⁴⁷⁹*Id.* § 21.104.

⁴⁸⁰An employment agreement may be the best way to prevent improper termination of a minority shareholder’s job with the company. *Ritchie*, 443 S.W.3d 856, 886 (Tex. 2014). (affirming commitment to at-will employment in absence of a written agreement).

⁴⁸¹TEX. BUS. ORGS. CODE ANN. § 21.107 (West 2012).

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 407

otherwise applicable.⁴⁸² Accordingly, a minority shareholder can't use a shareholder agreement as an end-run around the corporate form to stick the majority with personal liability.⁴⁸³ And shareholder agreements are not effective if the shares of the corporation are listed on a national securities exchange or regularly traded in certain markets.⁴⁸⁴

Shareholder agreements are not, moreover, "one size fits all." Two well-known commentators observed:

Drafters of the organizing documents of a closely held corporation cannot avoid a tradeoff. On the one hand, they must provide some protection to minority investors to ensure that they receive an adequate return on the minority shareholder's investment if the venture succeeds. On the other hand, they cannot give the minority too many rights, for the minority might exercise their rights in an opportunistic fashion to claim returns at the majority's expense.⁴⁸⁵

Decisions such as whether to mandate dividends under certain financial conditions, whether to allow shares to be sold to outside parties, the conditions and valuation methods under which minority shares will be repurchased, and whether one or more shareholders will have a guaranteed position or salary, depend on the specific circumstances and expectations of the parties. For example, a few investors intending to form a business with equal or nearly equal contributions likely need a very different arrangement than a business owner offering to sell or give shares of the company to an employee.

Similarly, the same dividend policy does not fit every situation. "Stockholders will often prefer different outcomes with respect to dividends; they have different investment time horizons, tax positions, and cash needs."⁴⁸⁶ And guaranteeing a shareholder a permanent management position or salary can hamstring future management of the company if the

⁴⁸² *Id.*

⁴⁸³ *See id.*

⁴⁸⁴ *Id.* § 21.109.

⁴⁸⁵ Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 285 (1986).

⁴⁸⁶ Dalley, *supra* note 218, at 216.

shareholder does not provide service commensurate with his or her guaranteed benefits.

Provisions requiring unanimous or “supermajority” votes on corporate decisions can lead to deadlock or manipulation by the minority:

A minority shareholder may refuse to attend meetings so that a quorum does not exist or refuse to consent to corporate acts, paralyzing the firm. Although this right helps minority shareholders protect themselves against opportunistic behavior by the majority, it creates incentives for the minority to behave opportunistically toward the majority to extract disproportionate concessions.⁴⁸⁷

Minority shareholders seeking such provisions in corporate bylaws should expect resistance from the majority. As one commentator has observed, “controlling stockholders have presumably paid for the right to control corporate decision-making. . . . Investors purchase controlling interests because they believe that their management ability will justify the price of a control premium.”⁴⁸⁸

2. Organizing as a Close Corporation

Shareholders can also provide themselves additional protections by choosing to operate as a close corporation.⁴⁸⁹ Although the terms are often treated as interchangeable, a “closely held” corporation is not necessarily a “close” corporation under Texas law. A Texas corporation with fewer than thirty-five shareholders and no shares traded on a national exchange is deemed a closely held corporation under Texas law—no action is required by the corporation to attain this status.⁴⁹⁰ Becoming a close corporation, on the other hand, requires insertion of specific language in the Certificate of Formation, either during formation or by amendment.⁴⁹¹ A corporation organized as a close corporation may also meet the definition of a closely held corporation. It is therefore possible for a corporation to be both “close” and “closely held.”

⁴⁸⁷ See Easterbrook & Fischel, *supra* note 485, at 296.

⁴⁸⁸ Dalley, *supra* note 218, at 220–21.

⁴⁸⁹ See TEX. BUS. ORGS. CODE ANN. §§ 21.101–.110 (West 2012).

⁴⁹⁰ *Id.* § 21.563.

⁴⁹¹ See *id.* § 21.701 *et seq.*

The permissible scope of shareholder agreements in close corporations is even broader than those permitted by § 21.101.⁴⁹² Additionally, shareholders in close corporations have access to statutory remedies unavailable to shareholders of ordinary corporations.⁴⁹³ Specifically, “shareholders in close corporations are authorized to institute proceedings to enforce a close corporation provision, appoint a provisional director, or appoint a custodian.”⁴⁹⁴ These proceedings could remedy many types of conduct typically complained of in shareholder oppression suits, including withholding dividends, misapplication of funds, and manipulation of stock values.⁴⁹⁵ There appear to be few cases to date where minority shareholders have sought, let alone received, such relief. In fact, *Ritchie* is the only case that cited § 21.752 at the time of this writing.⁴⁹⁶

To ensure these protective provisions are not unilaterally eliminated or amended without the consent of minority shareholders, the parties can consider requiring some type of “supermajority” to amend the company’s bylaws or certificate of formation.⁴⁹⁷ But such restrictions on the ability of majority shareholders to control corporate decision making can create additional risks that may ultimately not benefit minority shareholders:

Future investors will reduce the control premia they are willing to pay, and may be discouraged from making investments at all. Alternatively, the imposition of duties may discourage sole stockholders from selling interests in their businesses to minority investors, raising the cost of capital and eliminating investment opportunities.⁴⁹⁸

In the absence of a common law cause of action for oppression, more shareholders may begin to take advantage of these statutory provisions.

⁴⁹² See *id.* § 21.714.

⁴⁹³ See *id.* § 21.752.

⁴⁹⁴ *Ritchie v. Rupe*, 443 S.W.3d 856, 880 (Tex. 2014). (citing TEX. BUS. ORGS. CODE ANN. § 21.752 (West 2012)).

⁴⁹⁵ See, e.g., *Fischer v. Rider*, No. 02-10-00294-CV, 2011 Tex. App. LEXIS 385, at *5 (Tex. App.—Fort Worth Jan. 13, 2011, no pet.) (affirming trial court’s temporary injunction order where plaintiff sought, *inter alia*, appointment of a provisional director or custodian).

⁴⁹⁶ See *Ritchie*, 443 S.W.3d at 880.

⁴⁹⁷ TEX. BUS. ORGS. CODE ANN. § 21.708 (West 2012).

⁴⁹⁸ Dalley, *supra* note 218, at 221–22.

C. Legislative Action

To the extent the *Ritchie* ruling created a gap in the protection of minority shareholders, the Texas Supreme Court placed the responsibility for such gap squarely at the feet of the Texas Legislature.⁴⁹⁹ It noted the distinctions between the Texas receivership statutes and other states' statutes that have been found to support a broader claim for shareholder oppression.⁵⁰⁰ The Court pointed specifically to the Illinois statute that:

expressly authorizes a broad array of remedies, including the removal of an officer or director, the appointment of a custodian, the payment of dividends, the award of damages, and '[t]he purchase by the corporation or one or more other shareholders of all, but not less than all, of the shares of the petitioning shareholder.'⁵⁰¹

Thus, it held, "the Illinois legislature did exactly what the Texas legislature chose not to do: it expressly authorized, by statute, additional remedies beyond appointment of a receiver, including judicially mandated buyouts."⁵⁰² It noted that "the Illinois statute demonstrates how the Texas legislature could have statutorily authorized alternative remedies, but it did not."⁵⁰³ It therefore appears to be up to the Texas legislature to pass new legislation if it wants to provide additional avenues of relief for minority shareholders.

Such legislation, however, is not a panacea, and should be carefully crafted to avoid the problems associated with the common-law claims. The Illinois statute, which incorporates many of the common-law concepts discussed above, has been criticized for its "nebulous" standards for assessing the conduct of those governing a corporation.⁵⁰⁴ And as discussed in the previous section, imposing broad duties on a company's management

⁴⁹⁹ *Ritchie*, 443 S.W.3d at 872 n.25.

⁵⁰⁰ *Id.*

⁵⁰¹ *Id.* (citing 805 ILL. COMP. STAT. 5/12.56 (2015)). Statutes in some states expressly authorize an order requiring the "purchase at fair value of the shares of a shareholder" in certain circumstances. *See, e.g.*, MICH. COMP. LAWS § 450.1489 (2015); MINN. STAT. § 302A.751 (2015).

⁵⁰² *Ritchie*, 443 S.W.3d at 872 n.25.

⁵⁰³ *Id.*

⁵⁰⁴ *See* Timothy J. Storm, *Remedies for Oppression of Non-Controlling Shareholders in Illinois Closely-Held Corporations: An Idea Whose Times Has Gone*, 33 LOY. U. CHI. L.J. 379, 434-35 (2002).

2015] *SHAREHOLDER DISPUTES AFTER RITCHIE V. RUPE* 411

or mandating inflexible rights for minority shareholders can have consequences that may be neither fair nor economically efficient.⁵⁰⁵

A variety of legislative approaches have been proposed to address concerns about vulnerable shareholders.⁵⁰⁶ But any legislation in this area should carefully balance the rights of the majority and minority investors and provide shareholders the power to determine the rules under which they want to do business together.

VII. 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 based on its application of long-standing principles of corporate governance and fiduciary duties, 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 documents, such as shareholder agreements, employment contracts, and corporate bylaws.

⁵⁰⁵Eric W. Orts, *Shirking and Sharking: A Legal Theory of the Firm*, 16 YALE L. & POL'Y REV. 265, 319 n.282 (1998) (noting that "minority shareholders may exploit legal mechanisms designed to protect them at the expense of majority shareholders").

⁵⁰⁶See, e.g., Michael K. Molitor, *Eat Your Vegetables (Or At Least Understand Why You Should): Can Better Warning and Education Reduce Oppression in Closely Held Businesses?*, 14 FORDHAM J. CORP. & FIN. L. 491, 574-85 (2009); John H. Matheson & R. Kevin Maler, *A Simple Statutory Solution to Minority Oppression in the Closely Held Business*, 91 MINN. L. REV. 657 (2007); Adam Chernichaw, *Oppressed Shareholders in Close Corporations: A Market-Oriented Statutory Remedy*, 16 CARDOZO L. REV. 501 (1994).