Shareholder Oppression Claims in Texas: Current Developments, Considerations, and What Remains

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On June 24, 2014, in Ritchie v. Rupe, *the Texas Supreme Court changed the landscape of shareholder oppression claims in Texas, refusing to recognize a common-law cause of action for shareholder oppression and limiting relief to a receivership under the receivership statute. This discussion examines the history of shareholder oppression law in Texas, and this discussion considers the current state of the cause of action in light of this* Rupe *decision.*

Introduction

Until recently, shareholder oppression claims were increasingly common in the State of Texas. However, on June 24, 2014, in *Ritchie v. Rupe*, the Texas Supreme Court "declin[ed] to recognize or create a Texas common-law cause of action for 'minority oppression,'"[1] restricting the ability of noncontrolling shareholders to seek redress for oppressive acts, and providing a stricter definition of oppression than previously used by Texas courts.

This discussion examines the history of shareholder oppression law in Texas and considers the current state of this cause of action in light of the *Rupe* decision.

At its core, shareholder oppression involves a controlling shareholder acting as a "bully." The oppressor, or the controlling shareholder, is tantamount to the biggest kid on the playground with the nicest toys and is blessed with the power to make decisions for the entire playground (a controlling stake in the corporate entity) regardless of the interests or rights of the smaller kids. The smaller kids, or the oppressed noncontrolling shareholders, on the other hand, seem and feel powerless on the playground.

Noncontrolling shareholders have long searched for a solution to perceived abuses by the controlling shareholder. Shareholder oppression has evolved in fits and starts to provide this remedy.

The evolution of the shareholder oppression remedy has borrowed heavily over the years from related causes of action (e.g., fiduciary duty) and has been guided by ad hoc equitable remedies created by the courts. The increase in popularity of such claims mirrors shareholder remedies such as derivative suits designed to protect noncontrolling shareholders in publicly traded entities.

Prior to *Rupe*, several Texas courts of appeals have endorsed shareholder oppression and provided lengthy definitions of what constitutes such oppression, along with various forms of relief. Despite the *Rupe* decision, debate concerning the value of and necessity for shareholder oppression claims undoubtedly will continue in Texas and elsewhere.

There are certain noteworthy aspects of shareholder oppression law in Texas which should be taken into account. The first consideration is the background of oppression and its history. The second consideration in the area of shareholder oppression claims is choice of law.

Indeed, the determination of what body of law applies to a shareholder oppression claim is critical. Given the wildly differing definitions of oppression amongst the states, knowing what law to apply is

critical. The assumption that Texas law applies may not be warranted.

The differences between a shareholder oppression claim and a fiduciary duty claim should be studied prior to bringing suit, as similar facts characterizing the two claims may cause confusion. It is also important to note that in Texas, after the *Rupe* decision, there is no longer a recognized common-law cause of action for shareholder oppression. Accordingly, noncontrolling shareholders are limited to relief under the receivership statute and other common-law causes of action.

With a dynamic topic such as shareholder oppression, the unique facts of each case demand a thorough examination beyond that which is presented here. This is especially true with respect to closely held corporations where the personal dynamics of family and partnerships can result in more emotionally charged situations than typically accompany corporate governance disputes.

Choice of Law

Shareholder oppression law has evolved unevenly and sporadically across the country. Texas jurisprudence, for example, includes many oppression cases. The law in Delaware, on the other hand, is much more limited and much less explicit.

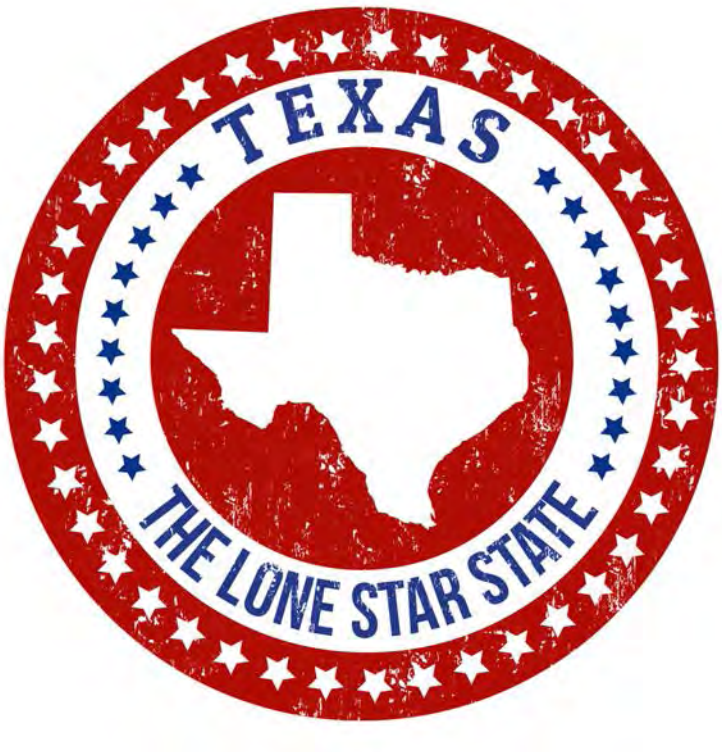
There are two theories on how to determine what law should apply to shareholder oppression cases. The first theory rests on the assumption that shareholder oppression is a tort and that, therefore, the "most significant relationship" test should apply. The second theory relies on an understanding of shareholder oppression as an outgrowth of corporate governance and applies the "internal affairs" doctrine.

The "Most Significant Relationship" Test

Some courts refer to shareholder oppression as a tort, suggesting at least possibly that choice of law for shareholder oppression should mirror choice of law for other torts.[2]

This is consistent with courts' understanding of shareholder oppression as "an expansive term that is used to cover a multitude of situations dealing with improper conduct . . . a narrow definition would be inappropriate."[3]

As a result, because oppression is a flexible remedy for conduct that, by definition, goes beyond any set standard for proper corporate conduct, it is a tort. Assuming oppression is a tort, the choice of law for shareholder oppression claims should arguably



be governed by standard tort principles, and not the law that may govern the mechanics of corporate governance.

Texas courts apply the "most significant relationship" test to determine what law applies to the substantive portion of a tort dispute.[4]

Seven factors are considered:

1. The needs of the interstate and international systems
2. The relevant policies of the forum
3. The relevant policies of other interested states and the relative interests of those states in the determination of the particular issue
4. The protection of justified expectations
5. The basic policies underlying the particular field of law
6. Certainty, predictability, and uniformity of result
7. Ease in the determination and application of the law to be applied.[5]

In most shareholder oppression cases in Texas, this analysis suggests that Texas law (rather than the state of incorporation) applies. Under this framework, the choice of law analysis in shareholder oppression cases resembles the choice of law analysis in any negligence case.

The "Internal Affairs" Doctrine

The second way to determine choice of law evolves from the Texas "internal affairs" doctrine and rests on the assumption that shareholder oppression is an outgrowth of corporate governance and should be governed by the law of the state of incorporation.

In theory, because the mechanics of shareholder oppression rely on minority shareholders frozen out of the corporate decision-making process to their detriment—an inherently "internal" act—then it follows that the "internal affairs" doctrine ought to apply and dictate which state's law should apply.

Internal affairs are defined by statute as "(1) the rights, powers, and duties of its governing authority, governing persons, officers, owners, and members; and (2) matters relating to its membership or ownership interests."[6]

Under the statute, disputes regarding these issues are determined by the application of the state law of the state of incorporation.

Case law interpreting choice of law in shareholder oppression cases is scant, and the Texas courts have never directly addressed the issue. However, there are some parallels between oppression and a Fifth Circuit opinion applying the internal affairs doctrine.[7]

That case, *Sommers*, involved a claim for breach of fiduciary duty against the Employee Retirement Income Security Act of 1974 (ERISA) trustee.[8] *Sommers* was not an oppression case, but it did involve some "internal" corporate issues. The Fifth Circuit found that because the dispute centered on management of the entity, the Internal Affairs doctrine applied and dictated that the state of incorporation's law would apply.[9] Significantly, there was no allegation of oppression by one shareholder of another in *Sommers*.

At least one case, though not from Texas, has decided between the two tests. In *Conway*,[10] a New Jersey court expressly declined to apply the internal affairs doctrine to resolve a choice of law issue in a shareholder oppression suit, relying instead upon local state law by virtue of the "most significant relationship" test.

The New Jersey definition of shareholder oppression tracks closely to the one emerging in Texas. Accordingly, *Conway* may offer some guidance on how Texas courts may ultimately decide the issue.

The choice of law is an issue that should be addressed early in shareholder oppression cases. This is because different states have different laws concerning shareholder oppression.[11]

The Evolution of Common Law Oppression

Prior to discussing the Texas Supreme Court's ruling in *Rupe*, it is important to understand the evolution of shareholder oppression in Texas. Although much of the case law developed over the years is no longer controlling, it played a central part in influencing the Texas Supreme Court decision in refusing to recognize a common-law cause of action for shareholder oppression and limiting statutory relief.

Texas State Cases

Texas shareholder oppression law has developed sporadically. Prior to *Rupe*, the Texas Supreme Court last addressed oppression in *Patton*[12] in 1955. *Patton* provides a helpful lens through which to view courts' struggles to create appropriate remedies for abuse of the corporate entity by a controlling shareholder.

The facts of *Patton* mirror those of typical oppression cases. Patton owned Machinery Sales & Company as an unincorporated business to purchase and sell goods, wares, and merchandise.[13] In 1940, Patton assigned a 10 percent interest each to Nicholas and Parks, and three years later increased it to 20 percent each.[14]

In 1955, the business was incorporated.[15] Patton sought to revoke the assignment, but was met with contention and they settled all disputes.[16] Although the business had a "highly prosperous record" and a "high level of business," the books showed decreased earnings and no dividends were paid.[17]

Patton, as the founder of the business, president, and owner of a clear majority of the stock, controlled the board "for the malicious purpose of, and with the actual result of, preventing dividends and otherwise lowering the value (if meaning current sale value in the market place) of the stock of the respondents. . . ."[18]

The court considered the remedy of liquidation, but noted that liquidation should be the "extreme or ultimate remedy," as it usually will involve accentuation of the economic waste incident to many receiverships and forced sales.[19]

Rather, the court fashioned a new remedy, a mandatory injunction requiring the corporation and Patton, as the dominant officer and stockholder, to declare and pay at the earliest date a reasonable dividend of the stock of the corporation.[20]

The court considered this remedy "fair and even necessary, considering the malicious character of the misconduct" involved and the possibility of repetition.[21]

Therefore, although the court did not specifically recognize a cause of action for "shareholder oppression," it certainly considered oppressive facts and tailored a remedy to assist the noncontrolling shareholders. Though the word "oppression" does not appear in *Patton*, the case nevertheless lays the groundwork for ensuing cases, including *Rupe*.

Following *Patton*, the development of shareholder oppression idled for decades. The next substantive development in Texas shareholder oppression came with *Davis v. Sheerin* in 1988.[22]

Davis represented the first adoption of a "definition" for shareholder oppression by Texas courts—ultimately the same definition that faced review by the Texas Supreme Court in *Rupe*.

James Sheerin and William Davis incorporated a business in which Davis owned 55 percent and Sheerin owned 45 percent of stock.[23] Sheerin was not employed by the corporation, and five years later they formed a partnership to acquire real estate.[24]

Almost 30 years later in 1985, Sheerin brought suit against Davis based on oppressive conduct.[25] Sheerin alleged that he was denied access to the corporate books, unless he produced his stock certificate, but Davis claimed that Sheerin made a gift of his stock to him in the late 1960s.[26]

After a six-week jury trial, the trial court entered a favorable verdict for Sheerin.[27]

On appeal, the court of appeals clarified the definition of oppressive conduct, as the Texas Business Corporation Act did not—and does not—provide a definition.[28] The court noted that a court may "determine, according to the facts of the particular case, whether the acts complained of serve to frustrate the legitimate expectations of noncontrolling shareholders, or whether the acts are of such severity as to warrant the requested relief."[29]

Additionally, the court quoted language borrowed from other states that included "burdensome, harsh and wrongful conduct," as well as "a visible departure from the standards of fair dealing"[30] as the definition of oppression.

The court of appeals upheld the trial court's judgment of oppressive conduct and held that a "buy-out" was an appropriate remedy.[31] As more fully discussed below, the Texas Supreme Court in *Rupe* held that a buy-out remedy under the receivership statute is no longer available.[32]

Davis is significant both for the endorsement of a definition for shareholder oppression subsequently adopted by other courts and for enabling the "buy-out" remedy. *Patton* commanded a dividend, not a buy-out. Like *Patton*, however, *Davis* relies upon the equitable power of the court.

The amorphous category of acts that could constitute shareholder oppression took further shape in another Houston case, *Willis*. Relying upon the *Davis* definition of oppression, the court of appeals in *Willis* clarified that "routine" business behavior did not constitute oppression.[33]

Instead, the court ruled that something more than hiring and firing of employees who owned stock was necessary.

Willis involved the classic closely held corporation makeup of owner/employees. A group of people started the "Fill-Er-Up Club" by forming RMF & JB Corporation.[34] Bydalek ran the club and owned 49 percent of the stock.[35]

Relations between the parties soured, and Bydalek alleged that he was locked out rather than quitting or being fired.[36] Bydalek filed suit. After a favorable jury verdict, the trial court entered judgment on the shareholder oppression claim, and awarded damages equal to the value of Bydalek's stock, along with punitive damages.[37]

On appeal, however, the court of appeals disagreed that the jury verdict supported a finding of shareholder oppression.[38] The court noted that the "minority shareholder's reasonable expectations must be balanced against the corporation's need to exercise its business judgment and run its business efficiently."[39] The court considered whether the jury finding of a wrongful lock-out actually amounted to shareholder oppression rather than just a firing.

The court held that "Willis did not oppress minority shareholder Joseph Bydalek by firing him when (1) the jury found no wrong besides a lock-out, (2) the corporation and Willis, personally, always lost money, both before and after the lock-out, and (3) the Bydaleks were at-will employees."[40]

The court concluded that the firing alone was "simply not the sort of 'burdensome, harsh, or wrongful conduct' or 'visible departure from the standards of fair dealing' that may constitute shareholder oppression."[41]

The acknowledgement of the independent importance of "business judgment" in the context of oppression provided a potential limit to liability and an important delineation between oppression and simple business disagreements with a shareholder. Indeed, as discussed below, the Texas Supreme Court in *Rupe* held that "conduct is oppressive only if it is inconsistent with the honest exercise of business judgment."[42]

Oppression, under *Davis*, *Rupe*, and *Willis*, favors disputes that focus on the exercise of shareholder rights rather than disputes over the business itself. There is an important nexus between the two

that must be established to create an oppression claim.

Following *Willis*, another court of appeals opinion, this time from *Tyler*, clarified the scope of oppression yet again. This case affirmed that abuse of the corporate power for personal benefit may constitute oppression.[43]

G.E.M. Transportation was a trucking company. Griffith incorporated the company and transferred 25 percent of the corporation's stock to Redmon. Disputes arose between the parties and Griffith terminated Redmon's positions with the company. Redmon filed suit against G.E.M. and the Griffiths claiming, among other things, shareholder oppression.[44]

The trial court signed a final judgment ordering that the parties take nothing on their respective claims against one another.[45] The court of appeals considered whether Redmon presented sufficient summary judgment evidence to create a genuine issue of fact with regard to the shareholder oppression claim.[46]

> Evidence concerning the use of corporate funds to pay personal expenses combined with evidence that Jim Redmon was denied access to information concerning the financial condition of the corporation sufficiently creates a material fact issue concerning whether there was a lack of probity and fair dealing in the company's affairs to the prejudice of the Redmons or otherwise, a visible departure from the standards of fair dealing, and a violation of fair play on which minority shareholders like the Redmons were entitled to rely. We hold that the trial court incorrectly granted summary judgment on the Redmons claim for shareholder oppression.[47]

Redmon follows *Willis* in that it involved a dispute over management. The distinction, however, is that in *Redmon* the firing of a business associate and co-owner was coupled with evidence suggesting that the controlling shareholder had taken corporate funds to spend on personal expenses.

Texas Federal Cases

Federal courts in Texas have taken the lead from state appellate courts with respect to oppression claims. Although federal court decisions are scarcer, the facts and holdings have mirrored those in state cases.

One of the most frequently cited cases to address oppression in Texas federal courts is *Rosenbaum*.[48] This case involves a typical case of corporate misuse, complete with a bankruptcy. The Rosenbaums owned a company called Cornerstone to sell a goat de-wormer known as "Positive Pellets" to commercial distributors.[49] The Rosenbaums approached Gage to invest in Cornerstone.[50]

Rosenbaum informed Gage that Cornerstone would make a lot of money and that Gage could expect to be compensated through his interest as a majority shareholder; that they would be partners in profit.[51] Although these statements were false, Gage initially paid over $250,000 for 505,000 shares in Cornerstone.[52]

After lengthy dealings and further investments, the Rosenbaums filed for bankruptcy. Gage filed a lawsuit against the Rosenbaums and requested the bankruptcy court to liquidate his claims against the Rosenbaums for noncontrolling shareholder oppression and other claims.[53]

Gage sought to recover his principal payment to Cornerstone of $324,400 and to recover punitive damages.[54]

In considering Gage's claim for shareholder oppression, the court noted that there "is no set standard for determining whether shareholder oppression has occurred."[55]

The court took a more holistic view. "Rather, the Court must examine the facts as a whole and determine whether the corporation's conduct has deprived a minority shareholder of the shareholder's reasonable expectations as an equity holder of the corporation."[56]

This followed the "equitable" approach to shareholder oppression adopted by the Texas appellate courts. The court concluded that noncontrolling shareholder oppression had occurred, as the Rosenbaums acted in concert and dominated the control of Cornerstone.[57]

Specifically, their conduct was oppressive as they transferred all of Cornerstone's assets to themselves and defeated Gage's expectations, which were both reasonable under the circumstances and central to his decision to invest in Cornerstone.[58] Therefore, the court entered judgment for Gage.[59]

While *Rosenbaum* involves a more egregious set of facts than many cases, the bankruptcy court's reliance on Texas law provided a useful guideline for a federal court's interpretation of the law prior to *Rupe*.

In *Bulacher*,[60] an interesting case testing whether or not shareholder oppression was recognized or not in Texas through Federal 12(b)(6) practice, the Northern District of Texas analyzed the cause of action through the prism of an incipient shareholder oppression suit.

Bulacher was a former employee and current shareholder of Enowa, a software consulting services firm managed by defendants.[61] Bulacher owned 17 percent of outstanding stock and filed suit alleging shareholder oppression.[62]

Bulacher alleged that Enowa breached his employment contract by terminating him without 30 days' written notice and claimed that Enowa engaged in oppressive conduct by diluting and depriving him of the value of his interest in Enowa.[63]

The defendants filed a motion to dismiss, and the court denied the motion, holding that the facts alleged by Bulacher are sufficient to state a claim for shareholder oppression under Texas law.[64]

Relying on *Willis* and *Davis*, the court considered the two-part definition of shareholder oppression and noted that "Texas courts take a broad view of the application of oppressive conduct to a closely-held corporation such as Enowa."[65]

This expansive view of oppression relied directly on *Willis* and *Davis*, the two cases discussed *supra* which, prior to *Rupe*, constituted the most substantive discussions of oppression by Texas courts.

The common law history of shareholder oppression shows courts searching for solutions to abuse in the context of a closely held corporation, and resorting to their equitable power to create one. Accordingly, prior to *Rupe*, Texas courts cumulatively developed a coherent definition of shareholder oppression with important limitations where the dispute must affect the noncontrolling shareholder's rights and the corporation itself must become involved.

How Is This Not Breach of Fiduciary Duty?

Given their similar histories, a natural interplay has arisen between breach of fiduciary duty and shareholder oppression claims. The question becomes what, if anything, distinguishes the two—a point raised repeatedly by the petitioners in the *Ritchie v. Rupe* briefing in the Texas Supreme Court and by the court itself.

Indeed, the court in *Rupe* noted that "the kinds of actions that support a shareholder action for receivership under the 'oppressive' prong of the statute are the kinds of conduct that also may support other causes of action, such as breach-of-fiduciary-duties to the corporation."[66]

The similarity between breach of fiduciary duty and shareholder oppression is in the presumably "close" relationship between plaintiff and defendant. The difference arises in how a party exercises his or her authority to violate the "trust" that arises between the two as a result of that relationship.

In the case of breach of fiduciary duty, the "breach" manifests itself through the offending party first being in a fiduciary relationship, including a broad range of behaviors from taking money from a trust account to drafting a document that is lopsided in favor of the fiduciary. In the case of shareholder oppression, the distinction is mechanical.

The controlling shareholder takes advantage of his superior position to use the corporation to his own benefit, to the injury of the noncontrolling shareholders. The noncontrolling shareholder, due to the makeup of the closely held corporation, does not have the necessary leverage to resist the controlling shareholder.

This fact victimizes the noncontrolling shareholder less in his relationship to the controlling shareholder than in his relationship to the corporation—undermining the expectations which led him to invest in the venture or to hold stock in the venture to begin with.

The relationship aspect of a shareholder oppression claim is geared less towards the controlling shareholder than towards the noncontrolling shareholder's frustrated relationship with the corporation—a frustration caused by the controlling shareholder's use of the corporate procedure. Where the "majority will" of controlling shareholder is not in the best interest of the corporation but in the best interest of the controlling shareholder, courts see oppression.[67]

Ritchie v. Rupe

On June 24, 2014, the Texas Supreme Court, in *Ritchie v. Rupe*, drastically changed the landscape of shareholder oppression claims in Texas. The court refused to recognize a common-law cause of action for shareholder oppression, limiting relief to a receivership under the receivership statute. The court also held that the receivership cannot be appointed unless the trial court determines lesser remedies would not be adequate.

The court also adopted more arduous standards for "oppressive" conduct other than the "fair dealing" and "reasonable expectations" tests previously used in Texas and discussed above.

Oppression, under the receivership statute, can now only occur if a corporation's controlling shareholders, directors, or officers "abuse their authority over the corporation with the intent to harm the interests of one or more of the shareholders, in a manner that does not comport with the honest

exercise of their business judgment, and by doing so create a serious harm to the corporation."[68]

Background

Rupe involved claims for shareholder oppression filed by a minority shareholder of the Rupe Investment Corporation (RIC), a closely held corporation. The trial court determined that plaintiff and minority shareholder, Ann Caldwell Rupe, had been subjected to shareholder oppression by RIC and some of its shareholders.[69]

RIC and other shareholders refused to meet with prospective purchasers of the stock and refused to allow any RIC management personnel to meet with prospective purchasers.[70]

Among other issues on appeal, the Dallas Court of Appeals considered whether the majority shareholders' conduct was oppressive and defined oppression as follows:

> Texas courts have generally recognized two non-exclusive definitions for shareholder oppression: 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.[71]

In considering what constitutes reasonable expectations, the court of appeals distinguished between specific and general reasonable expectations.[72]

Specific reasonable expectations are those specifically agreed to or expected as part of the transactions that develop over time, while general expectations are those that arise from the status of being a shareholder.[73]

The burdensome or oppressive definition "will often overlap the reasonable expectations definition because the standards of fair dealing on which all shareholders are entitled to rely will often include conduct necessary to meet the reasonable expectations of shareholders."[74]

The court of appeals ultimately held that the majority shareholders' conduct was oppressive in "refusing to meet or allow any officer or director of RIC to meet with prospective purchasers of the Stock because that conduct in this case substantially defeated Ann's general reasonable expectation of marketing the Stock."[75]

As a noncontrolling shareholder in a closely held corporation, the court held that Rupe had a general reasonable expectation that she could market the stock to third parties at whatever price the market would bear.[76]

The court of appeals also held that a "buy-out" remedy was available to Rupe whereby one remedy for the majority's oppression was a purchase by the majority of her stock at fair market value.[77]

Further, the court of appeals noted that "it is also reasonable to expect that the corporation and its management (as part of the standards of fair dealing on which all shareholders are entitled to rely) will consent to a shareholder's reasonable requests for cooperation with respect to her efforts to sell the stock."[78]

No Texas Common Law Cause of Action for Shareholder Oppression

The Texas Supreme Court reversed and remanded the case, holding that a common-law action for shareholder oppression is undesirable because it would require the adoption of a meaning of oppressive conduct that is different from the definition in the statutory receivership cause of action, as it "would merely duplicate the statutory cause of action while permitting remedies that the Legislature has chosen not to permit."[79]

Further, the "most developed common-law standards for 'oppression'—the 'reasonable expectations' and 'fair dealings' tests—have been heavily criticized for their lack of clarity and predictably."[80]

Additionally, the court noted that creating a common law cause of action is similar to "imposing on directors and officers a fiduciary duty to individual shareholders" and it would "permit courts to interfere with the freely negotiated terms of a private contract, or to insert into such a contract rights or obligations that the parties could have bargained for but did not."[81]

Defining Oppression in Texas

Rupe relied on the receivership statute as "authority for the trial court's judgment ordering RIC to buy out her shares."[82] The court, therefore, examined the receivership statute to determine the meaning of "oppressive."[83]

Texas does not have an "oppression" statute. The receivership statute, "former article 7.05 of the Texas Business Corporations Act, and its successor, section 11.404 of the Texas Business Organizations

Code, authorize Texas courts to appoint a receiver to rehabilitate a domestic corporation under certain circumstances."[84]

The statute states that a receivership may be declared when "the actions of the governing persons of the entity are illegal, ***oppressive***, or fraudulent."[85] Prior to *Rupe*, this statute was often relied upon by parties resisting a common-law shareholder oppression claim because the remedy was presumed superior to some of the previously available common-law remedies for shareholder oppression, particularly the "buy-out" remedy.[86]

Indeed, the petitioners in *Rupe* argued that the existence of this statute makes shareholder oppression unnecessary if not dangerous.[87]

In its decision, the Texas Supreme Court acknowledged "that the Legislature has never defined the term 'oppressive' in the Business Corporations Act or the Business Organizations Code."[88] It held that oppressive conduct had to "create exigent circumstances for the corporation."[89]

Indeed, the court noted that other scenarios where an appointment of a receiver was necessary involved situations that "pose[d] a serious threat to the well-being of the corporation."[90]

Further, oppressive conduct could not be conduct that was good for the corporation, even if bad for an individual shareholder.[91] The court held that "because a director is duty-bound to exercise business judgment for the sole benefit of the corporation, and not for the benefit of individual shareholders, [it could not] construe the term 'oppressive' in a manner that ignores that duty."[92]

Accordingly, conduct is oppressive only if it is "inconsistent with the honest exercise of business judgment and discretion by the board of directors."[93]

The court identified at least three characteristics of "actions" that the statute refers to as "oppressive":

1. The actions justify the harsh, temporary remedy of a rehabilitative receivership
2. The actions are severe and create exigent circumstances
3. The actions are inconsistent with the directors' duty to exercise their honest business judgment for the benefit of the corporation[94]

The court also provided a fourth characteristic that "the actions involve an unjust exercise or abuse of power that harms the rights or interests of persons subject to the actor's authority and disserves the purpose for which the power is authorized.[95]

The court noted that "[a]ctions that uniformly affect all shareholders typically will not satisfy this aspect of the term's meaning because, collectively, the shareholders of a business are not at the mercy of the business's directors."[96]

"'. . . conduct is oppressive only if it is 'inconsistent with the honest exercise of business judgment and discretion by the board of directors.'"

The court held that neither of the two tests previously used (the reasonable expectations and fair dealings tests) were appropriate because, in light of the above-mentioned characteristics, neither would be rigorous enough.[97]

The court held that the conduct was not oppressive because "the evidence does not support a finding that they abused their authority with the intent to harm Rupe's interests in RIC, or that their decision created a serious risk of harm to RIC."[98]

The conduct made it difficult for Rupe to sell her shares, but "[s]hareholders of closely held corporations may address and resolve such difficulties by entering into shareholder agreements."[99]

Remedies

Prior to *Rupe*, the equitable origins of shareholder oppression resulted in a broad but uncertain spectrum of potential remedies. From *Patton's* reliance upon a forced dividend, to the *Davis* endorsement of a so-called "buy-back," remedies for shareholder oppression were not clearly defined. These remedies compared favorably to the receivership statute, which places the minority shareholder's fate in the hands of a third party and may ultimately provide less value.

With the court's ruling in *Rupe*, shareholder oppression actions are now limited to the receivership statute and other common-law causes of action available to minority shareholders.

Receivership Statute

The limits of the receivership statute make it an attractive fire wall for defendants in shareholder oppression cases who seek to limit both the remedies available to plaintiffs and heighten the standard for liability.

The court in *Rupe* held that the lower court erred in ordering a buy-out of Rupe's shares because the provision relied upon in the receivership statute states, "[a] court may appoint a receiver under

"The Texas Supreme Court holding . . . eliminates the common-law cause of action for shareholder oppression, while endorsing other remaining common-law and statutory causes of action for minority shareholders."

Subsection (a) only if . . . the court determines that all other available legal and equitable remedies . . . are inadequate."[100] The lower court, therefore, had to consider lesser remedies first before ordering the buy-out.[101]

Going forward, trial courts will have to consider other forms of relief that provide lesser remedies. If lesser remedies are available, the trial court cannot appoint a receiver.[102]

Other Remedies

The Texas Supreme Court noted that it was not limiting remedies available under common law or statutes. Indeed, the court noted that "shareholders may also prevent and resolve common disputes by entering into a shareholders' agreement to govern their respective rights and obligations."[103]

It stated that "the Legislature has granted corporate founders and owners broad freedom to dictate for themselves the rights, duties, and procedures that govern their relationship with each other and with the corporation."[104]

Further, the court noted the various common-law causes of action that still exist to protect noncontrolling shareholders such as actions for "(1) an accounting , (2) breach of fiduciary duty, (3) breach of contract, (4) fraud and constructive fraud, (5) conversion, (6) fraudulent transfer, (7) conspiracy, (8) unjust enrichment, and (9) quantum meruit."[105]

Indeed, the court remanded the case to the court of appeals so that it could resolve any of the challenges to the breach of fiduciary duty claim alleged by Rupe.[106]

Conclusion

Shareholder oppression has certainly evolved in Texas, becoming increasingly popular in recent years. However, the Texas Supreme Court decision in *Rupe* sets forth limitations that will undoubtedly alter shareholder oppression claims for years to come.

Breach of fiduciary duty suits differ in their scope and their facts, while statutory shareholder oppression remains relatively underdeveloped and comparatively less friendly from the standpoint of remedies, especially given the holding in *Rupe*. In addition, the uncertain choice of law analysis for oppression creates numerous potential pitfalls for the unwary practitioner.

Choice of law, for example, creates issues that should have an impact on many corporate transactions, especially when choosing the state of incorporation due to the internal affairs doctrine.

The Texas Supreme Court holding in *Rupe* eliminates the common-law cause of action for shareholder oppression, while endorsing other remaining common-law and statutory causes of action for minority shareholders. A claim for shareholder oppression is now limited to Texas Business Organizations Code Section 11.404 and the only remedy available under it is a rehabilitative receivership.

In fact, on June 27, 2014, in *Cardiac Perfusion Services, Inc. v. Hughes*, the Texas Supreme Court, citing *Rupe*, reversed the lower court's decision, which ordered a buy-out of shares for shareholder oppression.[107]

The court in *Rupe* also adopted more arduous standards for "oppressive" conduct under the receivership statute other than the "fair dealing" and "reasonable expectations" tests previously used in Texas.

Oppression now occurs only if a corporation's controlling shareholders, directors, or officers "abuse their authority over the corporation with the intent to harm the interests of one or more of the shareholders, in a manner that does not comport with the honest exercise of their business judgment, and by doing so create a serious risk of harm to the corporation."[108]

Even without a common-law cause of action for shareholder oppression and a more limited receivership statute, noncontrolling shareholders still have various other avenues to recovery if they have been wronged. Not only can they still use the receivership statute, but noncontrolling shareholders can also use existing causes of action under Texas law to address misconduct, including claims for breach of fiduciary duty.

Moreover, as the court in *Rupe* noted, noncontrolling shareholders can protect themselves at the onset "by entering into shareholder agreements that contain buy-sell, first refusal, or redemption provisions that reflect their mutual expectations of agreements."[109]

Notes:

1. Ritchie v. Rupe, 443 S.W.3d 856, 860 (Tex. 2014), *reh'g denied* (Oct. 24, 2014).
2. See Cotten v. Weatherford Bancshares Inc., 187 S.W.3d 687, 702 (Tex. App.—Ft. Worth 2006, *pet. denied*) (considering oppression as a potential "underlying tort" to civil conspiracy); Willis

v. Donnelly, 118 S.W.3d 10, 30-31 (Tex. App.—Houston [14th Dist.] 2003), *aff'd in part and rev'd in part on other grounds*, 199 S.W.3d 262 (Tex. 2006) (determining that the breach of fiduciary duty elements of an oppression claim "sound in tort").

3. Davis v. Sheerin, 754 S.W.2d 375, 381 (Tex. App.—Houston [1st Dist.] 1988, *writ denied*).
4. Hughes Wood Prods. Inc. v. Wagner, 18 S.W.3d 202, 205 (Tex. 2000); Torrington Co. v. Stutzman, 46 S.W.3d 829, 847-50 (Tex. 2000); Gutierrez v. Collins, 583 S.W.2d 312, 318 (Tex. 1979).
5. Wagner, 18 S.W.3d at 205; Torrington Co., 46 S.W.3d at 847-50.
6. Tex. Bus. Org. Code § 1.105 (Vernon 2012).
7. Sommers Drug Stores Co. Emp. Profit Sharing Trust v. Corrigan, 883 F.2d 345 (5th Cir. 1989).
8. *Id.* at 348.
9. *Id.*
10. Conway v. DialAmerica Marketing, Inc., No. BER-C-116-08 (N.J. Super. Ct. Ch. Div. Sept. 30, 2008).
11. Delaware, for instance, has only one case on record which has squarely addressed oppression, Litle v. Waters, No. 12155, 1992 WL 25758 (Del. Ch. 1992). Further, Delaware courts have shied away from recognizing a common law tort of oppression, Nixon v. Blackwell, 626 A.2d 1366 (Del. 1993).
12. Patton v. Nicholas, 279 S.W.2d 848 (Tex. 1955).
13. Patton, 279 S.W.2d at 849.
14. *Id.*
15. *Id.*
16. *Id.* at 850.
17. *Id.* at 851.
18. *Id.* at 852.
19. *Id.* at 856-57.
20. *Id.* at 857.
21. *Id.* at 858.
22. Davis v. Sheerin, 754 S.W.2d 375 (Tex. App.—Houston [1st Dist.] 1988, *writ denied*).
23. Davis, 754 S.W.2d at 377.
24. *Id.*
25. *Id.*
26. *Id.*
27. *Id.* at 378.
28. *Id.* at 381.
29. *Id.* (citations omitted).
30. *Id.* at 382 (citations omitted).
31. *Id.* at 383.
32. Ritchie v. Rupe, 443 S.W.3d 856 (Tex. 2014), *reh'g denied* (Oct. 24, 2014).
33. Willis v. Bydalek, 997 S.W.2d 798, 801 (Tex. App.—Houston [1st Dist.] 1999, *pet. denied*).
34. Willis, 997 S.W.2d at 799.
35. *Id.* at 800.
36. *Id.*
37. *Id.* at 800—01.
38. *Id.* at 801.
39. *Id.* (citation omitted).
40. *Id.* at 802.
41. *Id.* at 802—03.
42. Ritchie v. Rupe, 443 S.W.3d 856, 869 (Tex. 2014), *reh'g denied* (Oct. 24, 2014) (internal citations omitted).
43. Redmon v. Griffith, 202 S.W.3d 225 (Tex. App.—Tyler 2006, *pet. denied*).
44. Redmon, 202 S.W.3d at 231.
45. *Id.*
46. *Id.*
47. *Id.* at 236.
48. In re Rosenbaum, No. 08-43029, 2010 WL 1856344 (Bankr. E.D. Tex. 2010).
49. Rosenbaum, 2010 WL 1856344, at *1.
50. *Id.* at 2.
51. *Id.*
52. *Id.* at 3.
53. *Id.* at 6.
54. *Id.*
55. *Id.* at 7 (citations omitted).
56. *Id.* (citations omitted).
57. *Id.*
58. *Id.*
59. *Id.* at 13.
60. Bulacher v. Enowa, L.L.C., No. 3:10-CV-156-M, 2010 WL 1135958 (N.D. Tex. March 23, 2010).
61. Bulacher, 2010 WL 1135958, at *1.
62. *Id.*
63. *Id.*
64. *Id.* at *2.
65. *Id.* (citations omitted).
66. Ritchie v. Rupe, 443 S.W.3d 856, 873 (Tex. 2014), *reh'g denied* (Oct. 24, 2014).
67. Rupe, 339 S.W.3d at 289 (citing Willis v. Bydalek, 997 S.W.2d 798, 801 (Tex. App.—Houston [1st Dist.] 1999, *pet. denied*); Redmon v. Griffith, 202 S.W.3d 225, 234 (Tex. App.—Tyler 2006, *pet. denied*); Pinnacle Data Servs., Inc. v. Gillen, 104 S.W.3d 188, 196 (Tex. App.—Texarkana 2003, no pet.); In re Rosenbaum, No. 08-43029, 2010 WL 1856344 at *7 (Bankr. E.D. Tex. May 7, 2010) (finding oppression as a result of misrepresentation and self-dealing, noting the defendants' "purposeful actions to dilute the value of [plaintiff's] investment while employing the business and its assets solely for their own benefit"); Davis v. Sheerin, 754 S.W.2d 375, 377-78, 382 (Tex. App.—Houston [1st Dist.] 1988, *writ denied*) (finding oppression in a case in which the

majority shareholders conspired to deprive the plaintiffs of their stock interest in the company by causing distributions to flow to themselves rather than the plaintiffs, while using corporate assets to pay their legal fees. The court found this plan and these actions were clearly oppressive because they not only substantially defeated the plaintiffs' reasonable expectations about stock ownership, but "would totally extinguish such expectations.").

68. Ritchie v. Rupe, 443 S.W.3d 856, 871 (Tex. 2014), *reh'g denied* (Oct. 24, 2014).
69. Rupe, 339 S.W.3d at 289.
70. *Id.* at 281.
71. Rupe, 339 S.W.3d at 289 (citing Willis v. Bydalek, 997 S.W.2d 798, 801 (Tex. App.—Houston [1st Dist.] 1999, *pet. denied*); Redmon v. Griffith, 202 S.W.3d 225, 234 (Tex. App.—Tyler 2006, *pet. denied*); Pinnacle Data Servs., Inc. v. Gillen, 104 S.W.3d 188, 196 (Tex. App.—Texarkana 2003, *no pet.*). This definition mirrors the one that slowly emerged in Texas law following the decision in Davis v. Sheerin, 754 S.W.2d 375 (Tex. App.—Houston [1st Dist.] 1988, *writ denied*), discussed infra.
72. Rupe, 339 S.W.3d at 290.
73. *Id.* at 291.
74. *Id.* at 294.
75. *Id.* at 296.
76. *Id.* at 294.
77. *Id.* at 302 (remanding to decide how to quantify "fair value").
78. *Id.* Prior to the Texas Supreme Court decision, Rupe was already relied upon by other Texas appellate courts analyzing oppression, most significantly and recently by Feldman and Konkel. In Feldman, a group of Houston urologists formed a Professional Association, Limited Partnership, and an LLC. Feldman, 2012 WL 1449726, at *1. When one of the urologists, Bernard Feldman, decided to wind down his practice and retire, he alleged that the other doctors began to freeze him out and defeat his legitimate and reasonable expectations for investing in the entities. *Id.* at *1-2. He filed suit claiming oppressive conduct, and the trial court granted summary judgment in favor of the defendants. *Id.* at *2. Noting that Texas recognizes a cause of action for shareholder oppression, the Houston Court of Appeals considered the summary judgment evidence and held that the defendants failed to meet their burden to establish, as a matter of law, "that their conduct did not fall within either definition of shareholder oppression…." *Id.* at *5. Feldman relied heavily upon Rupe in reaching its conclusions. Likewise, in Konkel, the Houston Court of Appeals held that the "acts found by the jury to have occurred in this case substantially defeated Konkel's general reasonable expectations as a [minority] shareholder." Konkel, 404 S.W.3d at 33. In reaching its decision, the Court quoted both definitions of oppression, focusing on Rupe's "reasonable expectations" *Id.*
79. Ritchie v. Rupe, 443 S.W.3d 856, 889 (Tex. 2014), *reh'g denied* (Oct. 24, 2014)
80. *Id.* at 890.
81. *Id.*
82. *Id.* at 863.
83. *Id.* Id.
84. Ritchie v. Rupe, 443 S.W.3d 856, 863 (Tex. 2014), *reh'g denied* (Oct. 24, 2014); TEX. BUS. ORGS. CODE § 11.404.
85. TEX. BUS. ORGS. CODE § 11.404(a)(1)(C) (emphasis added).
86. Ritchie v. Rupe, 339 S.W.3d at 289.
87. Petitioner's Brief on the Merits at *25, Ritchie v. Rupe (No. 11-0447) (filed June 13, 2012).
88. Ritchie v. Rupe, 443 S.W.3d 856, 866 (Tex. 2014), *reh'g denied* (Oct. 24, 2014).
89. *Id.* at 867.
90. *Id.* at 868.
91. *Id.* at 884.
92. *Id.* at 868.
93. *Id.* at 869.
94. Ritchie v. Rupe, 443 S.W.3d 856, 870 (Tex. 2014), *reh'g denied* (Oct. 24, 2014).
95. *Id.*
96. *Id.*
97. *Id.*
98. *Id.* at 871.
99. *Id.*
100. Ritchie v. Rupe, 443 S.W.3d 856, 898 (Tex. 2014), *reh'g denied* (Oct. 24, 2014).
101. *Id.*
102. *Id.* at 875.
103. *Id.* at 881.
104. *Id.*
105. *Id.* at 882.
106. Ritchie v. Rupe, 443 S.W.3d 856, 882 (Tex. 2014), *reh'g denied* (Oct. 24, 2014).
107. Cardiac Perfusion Servs., Inc. v. Hughes, 436 S.W.3d 790 (Tex. 2014).
108. Ritchie v. Rupe, 443 S.W.3d 856, 871 (Tex. 2014), *reh'g denied* (Oct. 24, 2014).
109. *Id.*

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