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SHAREHOLDER SUITS**Business Divorce Litigation in the Aftermath of ‘Ritchie v. Rupe’:
Concerns for Investors in Texas Businesses Have Been Greatly Exaggerated**

BY BENJAMIN L. RIEMER

Introduction

Based on the extensive commentary generated by the Texas Supreme Court’s recent decision in *Ritchie v. Rupe*,¹ it might appear that the ruling represents a seismic shift in the business litigation climate in Texas, giving rise to severe impediments for investors in Texas businesses. Such a doomsday scenario, however, is misplaced. *Ritchie* is certainly a fascinating and significant legal opinion from the Texas high court,

¹ *Ritchie v. Rupe*, No. 11-0447, 2014 BL 172924 (Tex. June 20, 2014).

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confronting cutting edge business law topics in Texas. For lawyers, *Ritchie* presents an interesting academic exercise, but the practical significance of the ruling for businesspeople and investors in Texas is likely to be more limited.

The Supreme Court’s ruling in *Ritchie* involved a review of: (1) a shareholder oppression claim under the Texas Receivership Statute, (2) brought by a minority shareholder, (3) of a closely held Texas corporation, (4) where the shareholder prevailed before the trial court, which (5) ordered the corporation to buy out the plaintiff’s shares for \$7.3 million. The Texas Supreme Court reversed the trial court’s judgment and in so doing, narrowed the legal standard used to evaluate shareholder oppression claims. Notably, the Supreme Court also eliminated the “buy-out” remedy for shareholder oppression claims altogether. Although the decision undoubtedly weakens the legal protections available to minority owners of closely held companies, the issues decided in *Ritchie* are not as earth shattering as some commentators would suggest.

Factual Background

The factual background giving rise to *Ritchie* is complex, but for purposes of this article, the facts can be simplified as follows. Ann Rupe inherited an 18 percent interest in Rupe Investment Corp., a closely held Texas corporation, from her husband, Dallas Gordon “Buddy” Rupe, III. Ann was Buddy’s second wife, and there was friction between Ann and the other company shareholders, including Ann’s sister-in-law, who also chaired the board. Given the conflicts between Ann and the other shareholders, Ann wanted the other shareholders to buy out her shares in the company. There were apparently some negotiations along these lines, which did not materialize, and Ann began pursuing third parties to purchase her interest.

Importantly, the other shareholders refused to meet with prospective purchasers, allegedly rendering it impossible for Ann to sell her shares. Ann then sued the other shareholders, alleging, among other things,

shareholder oppression. Ann prevailed at the trial court, which ordered the corporation to buy out Ann's shares for \$7.3 million. The Dallas Court of Appeals upheld the ruling, and the shareholders appealed to the Texas Supreme Court.

Legal Analysis

As an initial matter, the grounds asserted by the plaintiff in *Ritchie* as a basis for alleging "oppressive conduct" are notably weak. The minority shareholder alleged that she was oppressed because the company's other shareholders refused to meet with prospective buyers. In finding that this allegation did not give rise to a legally actionable claim for "shareholder oppression," the Supreme Court applied the "business judgment rule" and noted that the other shareholders had a reasonable concern that meeting with potential purchasers could expose the company to liability against an unsatisfied purchaser.

More importantly, in rejecting the plaintiff's oppression claim, the Supreme Court also discarded the previously accepted standards used to determine whether conduct is oppressive under Texas law and promulgated a more-onerous standard. Under the new standard for shareholder oppression claims in Texas:

a corporation's directors or managers engage in "oppressive" actions . . . 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.

Although the Supreme Court could have overturned the trial court's judgment simply on the basis that the conduct complained of did not constitute oppressive actions, the Supreme Court went a step further and eliminated the buy-out remedy altogether for such claims. The Supreme Court noted that the express language in the Texas Receivership Statute only allows for the appointment of a "rehabilitative" receiver and does not authorize the appointment of a "liquidating" receiver.

The Supreme Court's elimination of the buy-out remedy is likely the most important aspect of the case. The overarching importance of the "buy-out" remedy relates to the difficulties associated with the marketability of closely held companies. As the Supreme Court noted, "difficulty in—and sometimes even the impossibility of—selling one's shares is a characteristic intrinsic to ownership of a closely held corporation, the shares of which are not publicly traded." Given the hardships associated with selling interests in closely held companies, it has long been understood that the shareholders in such companies should seek to negotiate an exit strategy such as "shareholder agreements that contain buy-sell, first refusal, or redemption provisions." The Supreme Court's opinion in *Ritchie* reinforces the im-

portance of such provisions, but as a practical matter, it can be difficult for minority business owners to bargain for such protections.

Lessons Learned and Policy Proposal

There are several important takeaways that downplay the broad significance of the Texas Supreme Court's ruling in *Ritchie*. First, shareholder oppression claims still exist under the Texas Receivership Statute, although the plaintiff must now establish that the defendant not only abused his or her authority over the corporation, but did so with the intent to harm the interests of one or more of the shareholders, and by doing so created a serious risk of harm to the company. Although the buy-out remedy is now clearly unavailable for shareholder oppression claims, the court-ordered buy-out has always been a controversial subject. Indeed, the availability of a receivership has been, and continues to be, very limited under the express language of the statute, which requires, among other things, that "all other remedies available either at law or in equity" must be "inadequate." Importantly, the Supreme Court did not completely eliminate the buy-out remedy in Texas. To the contrary, it expressly held that the buy-out remedy may still exist based on a breach of fiduciary claim.

In addition, "shareholder oppression" claims are somewhat of a fringe issue in most business divorce cases. Even assuming a dispute arises in circumstances under which there is no shareholder agreement, there are usually several other claims available to the wronged minority business owner. More typical claims asserted in business divorce actions include: (1) petition for access to the company's books and records, (2) breach of fiduciary duty, and (3) breach of contract claims based on the company's governing agreements (i.e., limited partnership agreements, joint venture agreements, articles of incorporation, etc.). The *Ritchie* decision does not affect such claims whatsoever, and in fact, the Supreme Court remanded the case for further findings on the plaintiff's breach of fiduciary duty claim.

The Texas legislature should consider wading into these murky waters and adding the potential appointment of a "liquidating receiver" to the statute, such that under certain circumstances the buy-out remedy would be available for shareholder oppression claims. Obtaining such relief would still be extraordinarily rigorous, particularly given the new standard for determining "oppressive conduct." But authorizing the buy-out remedy under limited circumstances would add clarity to this area of the law and would bring Texas in line with the majority of jurisdictions that authorize the buy-out remedy for oppression claims. In the meantime, the practical effects of *Ritchie* are likely to be less significant than many commentators might suggest.