OPPRESSION OF MINORITY SHAREHOLDERS/MEMBERS

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Texas Monthly Super Lawyer Rising Star, 2005-2013
TYLA President's Award, 2011
TYLA President's Award of Merit, 2009-2010,
Director, Texas Young Lawyers Association (District 13), 2007 - 2009
Panel Chair, District 12b Grievance Committee, 2011-2012
Committee Chair, District 12 Grievance Committee, 2012-2013
Member, District 12 Grievance Committee, 2009-2014
Board of Advocates, Texas Trial Lawyers Association, 2007 - 2010
Texas Trial Lawyers Association, Membership Committee, 2005-2006
President, Hidalgo County Bar Association, 2006-2007
President-Elect, Hidalgo County Bar Association, 2005-2006
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Director, Hidalgo County Bar Association, 2003-2005
President, Hidalgo County Young Lawyers Association, 2005-2006
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CONTINUING LEGAL EDUCATION PRESENTATIONS

September 2009	Speaker, The Basics on Bad Faith and Suing Insurance Companies, TTLA Hidalgo County CLE

September 2010	Speaker, Satisfaction, Fulfillment, Wellness, and Happiness for the Beginning Lawyer, Hidalgo County Bar Association Attorney Mentor-Mentee Orientation and Training
November 2010	Speaker,Avoiding Disciplinary Action, Success Strategies and Key Lessons for Young Lawyers
May 2011	Speaker, Business “Divorces” in the Downturn, Soaking Up Some CLE, State Bar of Texas CLE
May 2012	Speaker, Arbitration: Do I Really Have to Go? Do I Have A Choice? Soaking Up Some CLE, State Bar of Texas CLE, A South Texas Litigation Seminar 2012
March 2013	Panel Speaker, Leadership SBOT Diversity & Leadership Panel
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November 2013	Speaker, Avoiding Disciplinary Action, Hidalgo County Bar Association Federal Law Conference
December 2013	Speaker, Motion Practice in Arbitration, Handling Your First (Or Next) Arbitration, State Bar of Texas CLE
March 2014	Speaker, Essentials of Business Law, Business “Divorces” in the Downturn, State Bar of Texas CLE
May 2014	Speaker, Avoiding Disciplinary Action, Soaking Up Some CLE, State Bar of Texas CLE

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I. INTRODUCTION

In situations where a minority shareholder would like to be bought out or leave the business, they sometimes run into situations which may be viewed as oppression by the majority shareholders. It is often believed that the majority shareholders hold all the power in the business. But is that really the case? And, if a minority shareholder comes to you with a scenario which appears to be oppressive, what advice can you give him and what actions can you take on his behalf?

II. WHAT IS "OPPRESSIVE" BEHAVIOR?

What qualifies as "oppressive" behavior by the majority shareholders? The term "oppressive" has never been defined by the Texas Legislature in either the Business Corporations Act or the Business Organizations Code. The term is used in Business Organizations Code §11.404:

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

V.T.C.A. Bus. Orgs. Code §11.404.

Since it was undefined prior to June of 2014, we would look to caselaw to determine how the term is to be construed. The seminal case on the issue was *Davis v. Sheerin*, 754 S.W.2d 375 (Tex.App.-Houston [1st Dist.] 1988, writ denied).

In the *Davis* case, Sheerin, who was a 45% owner of a closely held corporation, sued the company's president and 55% owner, Davis, alleging that Davis engaged in oppressive conduct and breached fiduciary duties owed to Sheerin and the company. *Id.* at 377. The jury returned a verdict in favor of Sheerin. *Id.* The trial court then appointed a rehabilitative receiver and ordered Davis to buy out Sheerin's interest. *Id.* at 378. Even though the statute does not expressly authorize a buy-out order and no other Court had ordered buyout without a buyout agreement, *Id.* at 378–79, the Houston Court of Appeals concluded that "Texas courts, under their general equity power, may decree a [buyout] in an appropriate case where less harsh remedies are inadequate to protect the rights of the parties." *Id.* at 380.

In order to determine the type of conduct that constitutes "oppressive" action under the statute, the *Davis* court concluded that "[c]ourts take an especially broad view of the application of oppressive conduct to a closely-held corporation, where oppression may more easily be found," *Id.* at 381. The Court of Appeals articulated two standard for oppression. The "reasonable expectation" test used a New York court's definition of oppression as occurring "when the majority's conduct substantially defeats the expectations that objectively viewed were both reasonable under the circumstances and were central to the minority shareholder's decision to join the venture." *Id.* at 381. The second test was the "fair dealing" test. It used an Oregon court's collection of definitions of oppression which included definitions such as "'burdensome, harsh and wrongful conduct,' 'a lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members,' or 'a visible departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.'" *Id. at* 382.

There has been a recent shift in the caselaw with the Texas Supreme Court's holdings in *Ritchie v. Rupe*, 2014 WL 2788335 (Tex. 2014). Prior to that holding, the Supreme Court had never construed former article 7.05 of the Texas Business Corporations Act or §11.404 of the Texas Business Organizations Code. This case did that and in turn upset prior rulings of the lower courts on "oppression". The Supreme Court rejected both the "fair dealing" test as well as the "reasonable expectations" test.

The Supreme Court ruled that "a corporation's directors or managers engage in 'oppressive' actions under former article 7.05 and section 11.404 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." *Ritchie v. Rupe, 2014 WL 2788335, *9 (Tex. 2014).*

III. APPLICATION OF NEW DEFINITION

Now that the Court has defined what oppression means in the context of §11.404 of the Business Organizations Code and its predecessor former article 7.05 of the Texas Business Corporations Act, what type of conduct will be considered "oppressive"?

In the context of *Ritchie*, the court determined that a refusal by the majority shareholders of a business to meet with the minority shareholder's potential buyer of

shares did not constitute an oppressive action for which relief would have been afforded under former article 7.05. *Id.* at *10.

The Court further determined that the evidence did not support a finding that the majority shareholders abused their authority with the intent to harm Rupe's interests in the company, or that their decision created a serious risk of harm to the company. *Id.* There was no contractual or statutory requirement that the shareholders meet with prospective buyers. *Id.* Without evidence of that type of behavior, the Court concluded that the majority shareholders refusal to meet with prospective buyers did not meet the definition of "oppressive" as that term is used in the receivership statute. *Id.*

The Supreme Court further declined to recognize a cause of action for common-law shareholder oppression citing to the adequacy of other legal protections such as a derivative action for breach of fiduciary duty. *Id. at 13.*

In a Court of Appels case out of Houston which was decided after the *Ritchie* opinion, the Court indicated that in making a determination as to whether shareholder oppression exists, the court must determine whether certain acts occurred as defined by the Supreme Court in *Ritchie*. *Batey v. Droluk,* 2014 WL 1408115 (Tex.App.-Hous. [1 Dist.], 2014), 14. The Houston Court of Appeals indicated that a "claim of oppressive conduct can be independently supported by evidence of a variety of conduct. Oppressive conduct is an independent ground for relief that does not require a showing of fraud, illegality, mismanagement, wasting of assets, or deadlock." *Davis v. Sheerin,*754 S.W.2d 375, 381-382 (Tex.App.—Hous. [1st Dist], 1988, no writ.).

IV. APPOINTMENT OF RECEIVER

If the minority shareholder can meet the definition of "oppressive" as defined in *Ritchie*, then a receiver may be appointed. However, the statute indicates that:

> "(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(a), are inadequate."

V.T.C.A. Bus. Orgs. Code §11.404.

While appointment of a rehabilitative receiver is available, the Court in *Ritchie* determined that other relief may be available other than appointment of a receiver, and the courts are required to consider such relief before appointing a rehabilitative receiver. *Ritchie,* 2014 WL 2788335, *11. If lesser remedies are available either in common law or through another statutory provisions, and those remedies are adequate, the Court cannot appoint a rehabilitative receiver. *Id.*

Since the release of the *Ritchie* case, there has not been a case released which finds that the parameters of the rehabilitative receiver portion of §11.404 have been met and a receiver should be appointed.

V. OTHER REMEDIES

While the Supreme Court may have more strictly defined the term "oppressive" thus limiting the scope and circumstances under which a minority shareholder would be entitled to have a rehabilitative receiver appointed, there are still remedies which exist for the minority shareholder. Minority shareholders have the right to assert causes of action 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.

*Ritchie at *21 citing to, Boehringer,* 404 S.W.3d at 24; *Shagrithaya,* 380 S.W.3d at 262; *Allen v. Devon Energy Holdings, L.L.C.,* 367 S.W.3d 355, 365 (Tex.App.-Houston [1st Dist.] 2012, judgm't set aside by agr.); *Strebel v. Wimberly,* 371 S.W.3d 267, 274 (Tex.App.-Houston [1st Dist.] 2012, pet. filed); *Adams v. StaxxRing, Inc.,* 344 S.W.3d 641, 643 (Tex.App.-Dallas 2011, pet. denied); *Redmon,* 202 S.W.3d at 231; *DeWoody v. Rippley,* 951 S.W.2d 935, 944 (Tex.App.-Fort Worth 1997, no writ); *Davis,* 754 S.W.2d at 377.

It is important that the minority shareholder determine whether the claims belong to the individual shareholder or to the company. The claims must be asserted in the appropriate capacity in order to recover under the claims. However, in the context of a closely held corporation, the Business Organizations Code does recognize a derivative proceeding by a shareholder which may be treated as a direct action brought by the shareholder. Section 21.563(c) states:

"(c) If justice requires:

1) 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; and
2) a recovery in a direct or derivative proceeding by a shareholder may be paid directly to the plaintiff or to the corporation if necessary to protect the interests of creditors or other shareholders of the corporation."

V.T.C.A. Bus. Orgs. Code §21.563(c).

A. Access to Books and Records

A common complaint of minority shareholders who are alleging shareholder oppression is that they are denied access to the corporation's books and records. The Business Organizations Code provides rights and relief for the shareholder in this position.

Texas Business Organizations Code §21.218 states:

(b) Subject to the governing documents and on written demand stating a proper purpose, a holder of shares of a corporation for at least six months immediately preceding the holder's demand, or a holder of at least five percent of all of the outstanding shares of a corporation, is entitled to examine and copy, at a reasonable time, the corporation's relevant books, records of account, minutes, and share transfer records. The examination may be conducted in person or through an agent, accountant, or attorney.

Tex. Bus. Orgs. Code §21.218

Further, section 21.219 allows for a shareholder, upon written request, to obtain annual statements of the corporation for the last fiscal year that contain in reasonable detail the corporation's assets and liabilities and the results of the corporation's operations; and the most recent interim statements, if any, that have been filed in a public record or other publication. *See Tex. Bus. Orgs. Code §*21.219.

Section 21.220 provides remedies and relief for shareholders when the shareholder suffers damages due to the failure of an officer or agent of a corporation who is in charge of the corporation's share transfer records and who does not prepare the list of shareholders, keep the list on file for a 10-day period, or produce and keep the list available for inspection at the annual meeting as required by Sections 21.354 and 21.372. *Tex. Bus. Orgs. Code §*21.220.

Under §21.222, the court may award costs and expenses, including attorney's fees against a corporation that refuses to allow a person to examine and make copies of account records, minutes, and share transfer records. *See* Tex. Bus. Orgs. Code §21.222.

A shareholder may also inspect voting lists under §21.354 and obtain the shareholder meeting list under §21.372.

All of these sections afford the minority shareholder protection in the event that they are not afforded access to books and records of the company.

B. Dividends

There are a variety of complaints by minority shareholders alleging oppression that pertain to the company's dividends. Some of those complaints include the company's failure to declare dividends, the failure to declare higher dividends, and withholding dividend payments after the company has declared the dividends.

In a situation where directors breach their fiduciary duties by withholding or failing to declare dividends, a shareholder can sue the directors for breach of those duties on behalf of the corporation through a derivative action under Business Organizations Code §§ 21.551–21.563.

C. Misapplication of Funds

This seems to be the most common complaint that I have seen in my practice with the oppressed minority shareholder. The complaint being that the other officers and directors are misusing or misapplying the company funds.

The caselaw is well settled that the officers and directors owe a duty of loyalty to the corporation which does not allow for them to misapply corporate assets for their personal gain or from wrongfully diverting corporate opportunities to themselves. *See, International Bankers Life Ins. Co. v. Holloway,* 368 S.W.2d 567,576 (Tex. 1963). Should a shareholder be found to have violated this obligation, he will be held liable and accountable to the corporation for his profits. *Id.*

D. Breach of Fiduciary Duty

Partners in a general partnership owe each other a fiduciary duty. *M.R. Champion v. Mizell*, 904 S.W.2d 617, 618 (Tex.1995). In Miller, the Dallas Court of Appeals held that the majority shareholders' intimate knowledge of company's affairs supported finding fiduciary relationship. *Miller v. Miller*, 700 S.W.2d 941, 945–46 (Tex.App.-Dallas 1985, writ ref'd n.r.e.).

Directors of a corporation are in a fiduciary relationship to the corporation and its stockholders.

Tex. Bus. Orgs. Code §7.001. They cannot act such in a manner in which a director's interest is adverse to that of the corporation. *Id.* Also, directors cannot appropriate the property of the corporation for their benefit, nor should they permit others to do so. *Id.*

If a minority shareholder believes that a director is acting inconsistently with Business Organizations Code §7.001, he can bring suit on behalf of the company in the form of a derivative action. *See Wingate v. Hajdik*, 795 S.W.2d 717, 719 (Tex.1990) (holding that sole shareholder could recover on behalf of company, but not in individual capacity, for former shareholder and officer's misappropriation of corporate assets).

Texas Business Organizations Code §7.001 states that there is no elimination or limitation of liability for causes of action brought against a person governing the company for:

1) a breach of the person's duty of loyalty, if any, to the organization or its owners or members;
2) an act or omission not in good faith that:
    a) constitutes a breach of duty of the person to the organization; or
    b) involves intentional misconduct or a knowing violation of law;
3) a transaction from which the person received an improper benefit, regardless of whether the benefit resulted from an action taken within the scope of the person's duties; or
4) an act or omission for which the liability of a governing person is expressly provided by an applicable statute.

Tex. Bus. Orgs. Code §7.001

This breach of fiduciary duty may also be created informally. The San Antonio Court of Appeals in the Vejara case determined that while not a majority shareholder, Vejara exhibited the same type of control and had intimate knowledge of the company's affairs. *Vejara v. Levoir International*, 2012 WL 5354681, *5 (Tex.App.-San Antonio, pet. denied). The evidence was that Vejara created the company, entered into leases on behalf of the company, held keys to the company's vans, and had exclusive access to the company's inventory held in storage. *Id.* The Court held that Vejar's control and intimate knowledge of the company's affairs and plans gave rise to the existence of an informal fiduciary duty to Levior. *Id.*

VI. DAMAGES

Courts may fashion equitable remedies such as profit disgorgement and fee forfeiture to remedy a breach of a fiduciary duty. *ERI Consulting Eng'rs, Inc. v. Swinnea*, 381 S.W.3d 867, 873 (Tex. 2010); *see also Burrow v. Arce*, 997 S.W.2d 229, 237 (Tex.1999). This would apply to causes of action for misapplication or misappropriation of property as they are essentially breach of fiduciary duty claims.

Also, there are remedies specified directly in the Business Organizations Code which may be available to the minority shareholder who claims oppression by majority shareholders.

VII. CONCLUSION

Simply because your client is a minority shareholder in a company does not mean that they are without remedies when faced with a situation in which they feel oppressed by the majority shareholders of the company. Look to the Texas Business Organizations Code as the first step for finding relief for your client.