

**THE DEMISE OF THE SHAREHOLDER OPPRESSION
DOCTRINE IN TEXAS: PURSUIT OF CLAIMS BY
MINORITY SHAREHOLDERS (AND LLC MEMBERS)
AFTER *RITCHIE V. RUPE***

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CHAPTER 13.1

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The Demise of the Shareholder Oppression Doctrine in Texas: Pursuit of Claims by Minority Shareholders (and LLC Members) After *Ritchie v. Rupe*

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I. The Demise of the Shareholder Oppression Doctrine

Until 2014, courts of appeals in Texas had recognized the availability of various equitable remedies, including a court-ordered buyout, where a minority shareholder established that the majority shareholder engaged in “oppressive” conduct. “Oppressive” conduct was defined by the courts as:

- (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 invest; 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.

Davis v. Sheerin, 754 S.W.2d 375, 381-82 (Tex. App.—Houston [1st Dist.] 1988, writ denied) (awarding minority shareholder an equitable buyout at fair value as determined by the jury based upon the majority’s refusal to recognize the minority’s ownership in the corporation). The seminal case in this area was *Davis v. Sheerin*. In the years after the *Davis* case, oppression cases in Texas appeared with increasing frequency. Some courts also applied the shareholder oppression doctrine in the context of limited liability companies.

In a landmark 6-3 opinion in 2014, the Texas Supreme Court disapproved of the manner in which courts of appeals had been applying the oppression doctrine and significantly limited the reach of the oppression doctrine. In *Ritchie v. Rupe*, 443 S.W.3d 856 (Tex. 2014), the court: (1) rejected the “reasonable expectations” and “fair dealing” tests for oppression that courts of appeals had been applying in Texas since 1988 and adopted a definition requiring abuse of authority by management with intent to harm an owner in disregard of management’s honest business judgment; (2) held that a rehabilitative receivership is the only remedy for oppression under Section 11.404 of the Business Organizations Code; and (3) declined to recognize a common-law cause of action for oppression.

The majority in *Ritchie v. Rupe* discussed at length the policy reasons for its decision and “the adequacy of remedies that already exist.” A side-by-side overview and comparison of the supreme court’s analysis in *Ritchie v. Rupe* and the case law in Texas prior to *Ritchie v. Rupe* is set forth at the end of this paper. Below are some observations and suggestions regarding the manner in which aggrieved minority owners of corporations and LLCs may seek to redress their grievances after *Ritchie v. Rupe*.

II. What Strategies Will be Employed by Minority Owners in the Post-*Ritchie v. Rupe* Era?

After *Ritchie v. Rupe*, some of the strategies that are likely to be pursued by minority owners aggrieved by the majority's conduct with respect to the entity are as follows:

- Characterize the majority's conduct as a breach of fiduciary duty to the entity:
 - Seek damages or rely on equitable principles to recover a disgorgement remedy, court-ordered dividends, or other injunctive relief for a breach of fiduciary duty to the entity based on improper benefit by the majority even if damages to the corporation or LLC cannot be shown; and
 - Rely on the statutory provisions governing derivative suits involving closely held corporations and LLCs to recover directly for the breach of fiduciary duty to the entity (in contrast to the traditional result in a derivative suit where the recovery is paid to the entity).
- Establish the existence of an informal fiduciary duty owed by the majority to the minority based on a special relationship and pursue legal or equitable remedies, possibly including a court-ordered buyout.
- Characterize the majority's conduct as grounds for a rehabilitating receivership or judicially decreed winding up.
- Characterize the majority's conduct as a breach of contract between the minority owner and the entity or majority.
- Characterize the majority's conduct as fraudulent.

The strategies listed above are further discussed below. In addition, minority shareholders in some cases may be able to avail themselves of one or more of the following causes of action: an accounting, conversion, fraudulent transfer, conspiracy, unjust enrichment, and quantum meruit. *See Ritchie v. Rupe*, 443 S.W.3d at 882 (listing these among various causes of action asserted by minority shareholders in prior cases to redress the same conduct on which oppression claims were based).

III. Minority Owners Will Assert Breaches of Fiduciary Duty Owed to the Corporation (or LLC)

Given the state of the law in Texas after *Ritchie v. Rupe*, aggrieved minority shareholders and LLC members in many cases can be expected to characterize the conduct of which they complain as a breach of fiduciary duty to the corporation or LLC rather than as "oppressive" conduct. (If the conduct satisfies the new definition of "oppression" set forth in *Ritchie v. Rupe*, the plaintiff may also assert an oppression claim but will be limited to obtaining a receivership as a remedy for the oppression claim, and a receivership will only be available if the court determines that the available remedies for breach of fiduciary duty are inadequate.)

A. Corporate Officers and Directors Owe Fiduciary Duties to the Corporation (Not to Individual Shareholders)

The Texas Supreme Court in *Ritchie v. Rupe* stressed that corporate officers and directors owe their fiduciary duties to the corporation and not to individual shareholders. 443 S.W.3d at 888-91. The court also appeared to reject the notion that a majority shareholder owes any formal fiduciary duty to a minority shareholder, stating that “this Court has never recognized a formal fiduciary duty between majority and minority shareholders in a closely-held corporation [citation omitted], and no party has asked us to do so here.” *Id.* at 874-75 n. 27. The court also stated that “[t]he dissent’s contention that this Court should recognize a common-law duty between majority and minority shareholders, rather than between corporate controllers and the corporation, for [misapplication of corporate funds and diversion of corporate opportunities] is contrary to well-established Texas law.” *Id.* at 887 n. 54. Even before *Ritchie v. Rupe*, most courts of appeals in Texas had taken the position that a majority shareholder, even in a closely held corporation, does not generally owe a minority shareholder a fiduciary duty. *See, e.g., Allen v. Devon Energy Holdings, L.L.C.*, 367 S.W.3d 355, 391 (Tex. App.—Houston [1st Dist.] 2012, pet. granted, judgment vacated w.r.m.); *Pabich v. Kellar*, 71 S.W.3d 500 (Tex. App.—Fort Worth 2002, pet. denied); *Hoggett v. Brown*, 971 S.W.2d 472, 488 (Tex. App.—Houston [14th Dist.] 1997, pet. denied); *Schoellkopf v. Pledger*, 739 S.W.2d 914, 920 (Tex. App.—Dallas 1984), rev’d on other grounds, 762 S.W.2d 145 (Tex. 1988); *Kaspar v. Thorne*, 755 S.W.2d 151 (Tex. App.—Dallas 1988, no writ).

Although Texas courts have rejected the proposition that co-shareholders owe one another fiduciary duties, the First Court of Appeals in Houston concluded in 2012 that a controlling insider of a corporation or LLC owes a formal fiduciary duty to a passive minority owner in the context of a buyout of the minority’s interest. *Allen v. Devon Energy Holdings, L.L.C.* 367 S.W.3d 355, 395-96 (Tex. App.—Houston [1st Dist.] 2012, pet. granted, judgment vacated w.r.m.). The court engaged in a lengthy analysis of corporate case law within and outside Texas and interpreted Texas case law in the corporate context as supporting recognition of a formal fiduciary duty on the part of an insider when purchasing a passive minority shareholder’s shares. *Id.* at 393-96. Based on that case law, the court in *Allen* held that in the LLC context “there is a formal fiduciary duty when (1) the alleged-fiduciary has a legal right of control and exercises the control by virtue of his status as the majority owner and sole member-manager of a closely-held LLC and (2) either purchases a minority shareholder’s interest or causes the LLC to do so through a redemption when the result of the redemption is an increased ownership interest for the majority owner and sole manager.” *Id.* at 395-96. Whether the court’s analysis of fiduciary duties in *Allen* will be affected by *Ritchie v. Rupe* remains to be seen.

B. Wrongful Suppression of Dividends May be a Breach of Fiduciary Duty to the Corporation

The supreme court’s discussion in *Ritchie v. Rupe* of its 1955 decision in *Patton v. Nicholas* provides a basis to argue that a wrongful failure to pay dividends constitutes a breach of fiduciary duty to the corporation (which would give rise to a derivative claim by the minority shareholder). In *Ritchie v. Rupe*, the supreme court explained that the founding/controlling shareholder’s failure to declare dividends in *Patton v. Nicholas*, 279 S.W.2d 848 (Tex. 1955), was a breach of fiduciary duty to the corporation. 443 S.W.3d at 884-85. As Justice Guzman pointed out in her dissenting opinion in *Ritchie v. Rupe*, it is difficult to see how preserving a corporation’s capital by not paying dividends results in harm to the corporation. 443 S.W.3d at 904 n. 48 (Guzman, J., dissenting). If (as is sometimes the case where a

wrongful refusal to declare dividends is alleged) those in control are paying themselves excessive salaries (thus essentially paying themselves a disguised dividend), then there would be a measurable “injury” to the corporation on which to base damages or an improper “benefit” to the defendant on which to base disgorgement. Absent accompanying improper payments that constitute disguised dividends to those in control, would the failure to declare dividends ever be a breach of fiduciary duty to the corporation?

The supreme court in *Patton v. Nicholas* characterized the malicious suppression of dividends by the majority shareholder in that case as a “wrong akin to a breach of trust” even though the jury found that the majority shareholder did not cause himself to be paid an excessive salary and there was insufficient evidence to show mismanagement by the majority shareholder. 279 S.W.2d at 852-54. There was evidence to show that the majority shareholder intended eventually to acquire the minority shareholders’ stock for much less than its value, and the *Patton* court recognized that the minority’s ability to hold their stock or to sell it to third parties at a fair value would be lessened by the absence of dividends. *Id.* at 853. The court in *Ritchie v. Rupe* stated that Patton’s use of “his control of the board for the malicious purpose of . . . preventing dividends and otherwise lowering the value . . . of the stock of the [minority shareholders]” was a breach of fiduciary duty to the corporation and further explained that *Patton* “demonstrates that when a corporate director violates the duty to act solely for the benefit of the corporation and refuses to declare dividends for some other, improper purpose, the director breaches fiduciary duties to the corporation.” *Ritchie v. Rupe*, 443 S.W.3d at 884.

The court’s recognition in *Ritchie v. Rupe* that the malicious suppression of dividends in *Patton* was an actionable breach of fiduciary duty is significant because the court in *Patton* ultimately concluded that: (1) there was no actual loss suffered by the corporation (there being “no evidence that the misconduct of the [majority shareholder] reduced the net worth of the corporation or that it resulted in a smaller present net worth than would otherwise have existed”), and (2) there was no devaluation of the minority shareholders’ stock since there was no market for the stock. *Patton*, 279 S.W.2d at 858. The only injury suffered was the deprivation of dividends by the shareholders, which was remedied by equitable relief in the form of an injunction ordering the payment of dividends. *Id.* The reasoning in *Patton* that the controlling shareholder’s use of his control for a selfish purpose in *Patton* was a breach of fiduciary duty even though it did not harm the corporation might arguably be extended to other acts that do not harm the corporation if the minority shareholder can show that the act was motivated solely by a desire to disadvantage the minority. Of course, absent direct evidence revealing the majority’s malice (such as the correspondence and oral statements of the majority shareholder in *Patton*), the minority may have difficulty establishing that the action taken was not motivated by concern for the corporation’s well being so as to fall outside the protection of the business judgment rule.

C. Courts in Texas Have Thus Far Generally Analogized to Corporate Case Law Regarding Fiduciary Duties in LLCs

The Texas Supreme Court has not addressed what, if any, fiduciary duties are owed and to whom in the LLC context under Texas law. Bankruptcy courts in some cases have analyzed breach-of-fiduciary-duty claims against LLC members who were also officers of the LLC in terms of the duties of corporate officers without indicating any recognition that an LLC is not actually a corporation. See *In re Supplement Spot, LLC*, 409 B.R. 187 (Bankr. S.D. Tex. 2009); *In re Brentwood Lexford Partners, L.L.C.*, 292 B.R. 255 (Bankr. N.D. Tex. 2003); *Anderson v. Mega Lift Sys., L.L.C. (In re Mega Sys., L.L.C.)*, Bankr. No. 03-30190, Adv. No. 04-6085, 2007 WL 1643182 (Bankr. E.D. Tex. June 4, 2007). A couple of recent

bankruptcy decisions have recognized that LLC managers owe fiduciary duties to the LLC based on agency law or the LLC statutes and governing documents of the LLC. *See Zayler v. Calicutt (In re TSC Sieber Servs., LC)*, Bankr. No. 09-61042, Adv. No. 10-6031, 2012 WL 5046820 (Bankr. E.D. Tex. Oct. 18, 2012) (finding that individual who exercised managerial control over LLC owed a formal fiduciary duty to the LLC because he was an agent of the LLC); *Pacific Addax Co., Inc. v. Lau (In re Lau)*, Bankr. No. 11-40284, Adv. No. 11-4203, 2013 WL 5935616 (Bankr. E.D. Tex. Nov. 4, 2013) (stating that LLC statute implies that certain duties may be owed without defining them and allows contracting parties to specify the breadth of those duties in the company agreement).

Analogizing to the corporate context, numerous courts in Texas have espoused the view that members of an LLC do not necessarily owe other members fiduciary duties (consistent with corporate case law in which the courts have stated that co-shareholders in a closely held corporation do not as a matter of law owe one another fiduciary duties). *Allen v. Devon Energy Holdings, L.L.C.*, 367 S.W.3d 355, 391 (Tex. App.—Houston [1st Dist.] 2012, pet. granted judgment vacated w.r.m.); *Vejara v. Levior Int'l, LLC*, No. 04-11-00595-CV, 2012 WL 5354681 (Tex. App.—San Antonio Oct. 31, 2012, pet. denied); *Suntech Processing Sys., L.L.C. v. Sun Commc'ns, Inc.*, No. 05-99-00213, 2000 WL 1780236 *6 (Tex. App.—Dallas Dec. 5, 2000, pet. denied); *Fed. Ins. Co. v. Rodman, LLC*, No. 3:10-CV-2042-B, 2011 WL 5921529 *3 (N.D. Tex. Nov. 29, 2011); *Entm't Merch. Tech., L.L.C. v. Houchin*, 720 F. Supp. 2d 792, 797 (N.D. Tex. 2010); *Gadin v. Societe Captrade*, No. 08-3773, 2009 WL 1704049 *3 (S.D. Tex. 2009); *ETRG Invs., LLC v. Hardee (In re Hardee)*, Bankr. No. 11-60242, Adv. No. 11-6011, 2013 WL 1084494 *10 (Bankr. E.D. Tex. Mar. 14, 2013); *see also Mullen v. Jones (In re Jones)*, 445 B.R. 677, 710 n.112 (Bankr. N.D. Tex. 2011) (commenting that the law seems to be developing toward the notion that members of an LLC do not necessarily owe other members fiduciary duties); *but see Allen*, 367 S.W.3d at 393 (suggesting that the relationship of the passive minority member and controlling/managing member of the LLC at issue was similar to that of a general partner and limited partner in a limited partnership, thus supporting recognition of a fiduciary duty owed by the controlling/managing member to the passive minority member); *Cardwell v. Gurley*, No. 4-10-CV-706, 2011 WL 6338813 *3, 9-10 (E.D. Tex. Dec. 19, 2011) (reciting conclusions of law of 134th District Court in Dallas County in previous litigation in which the district court concluded the managing member of an LLC owed the other member direct fiduciary duties of loyalty, care, and disclosure, as well as owing such duties to the LLC; holding the bankruptcy court did not err in giving preclusive effect to the state district court's findings and conclusions; holding the fiduciary duty owed by a managing member to his fellow LLC member was similar to the trust-type obligation owed by partners and corporate officers and thus sufficient to support an exception to discharge under Section 523(a)(4) of the Bankruptcy Code).

IV. Minority Owners May Seek to Obtain Equitable Relief for Breach of Fiduciary Duty

Texas cases routinely describe the elements of a claim for breach of fiduciary duty as follows: (1) a fiduciary relationship between the plaintiff and defendant; (2) the defendant must have breached his fiduciary duty to the plaintiff; and (3) the defendant's breach must result in injury to the plaintiff or benefit to the defendant. *See, e.g., Anderton v. Cawley*, 378 S.W.3d 38 (Tex. App.—Dallas 2012, no pet.); *Lindley v. McKnight*, 349 S.W.3d 113 (Tex. App.—Fort Worth 2011, no pet.); *Lundy v. Masson*, 260 S.W.3d 482 (Tex. App.—Houston [14th Dist.] 2008, pet. denied); *Jones v. Blume*, 196 S.W.3d 440 (Tex. App.—Dallas 2006, pet. denied).

Note that the third element above is stated in the disjunctive such that a benefit obtained by the defendant as a result of a breach of fiduciary duty may support recovery even though the plaintiff does not suffer actual damages. This aspect of a claim for breach of fiduciary duty is the basis for equitable remedies such as fee forfeiture or other types of disgorgement. See *Burrow v. Arce*, 997 S.W.2d 229 (Tex. 1999) (fee forfeiture in attorney-client context); *ERI Consulting Engineers, Inc. v. Swinnea*, 318 S.W.3d 867 (Tex. 2010) (forfeiture of contractual consideration in sale of business interests); *Kinzbach Tool Co. v. Corbett-Wallace Corp.*, 138 Tex. 565, 160 S.W.2d 509 (1942) (forfeiture of commission received by agent from third party). The Texas Supreme Court addressed this principle in *Kinzbach Tool Co.* as follows:

A fiduciary cannot say to the one to whom he bears such relationship: You have sustained no loss by my misconduct in receiving a commission from a party opposite to you, and therefore you are without remedy. It would be a dangerous precedent for us to say that unless some affirmative loss can be shown, the person who has violated his fiduciary relationship with another may hold on to any secret gain or benefit he may have thereby acquired. It is the law that in such instances if the fiduciary "takes any gift, gratuity, or benefit in violation of his duty, or acquires any interest adverse to his principal, without a full disclosure, it is a betrayal of his trust and a breach of confidence, and he must account to his principal for all he has received."

160 S.W.2d at 514.

Thus, in the context of a suit brought by a minority owner derivatively on behalf of a corporation or LLC, the third element of the claim for a breach of fiduciary duty would be satisfied by either injury to the entity or benefit to the defendant resulting from the breach. Damages may be recoverable based on injury to the entity, or a benefit realized by the defendant may be recoverable on the entity's behalf pursuant to a disgorgement remedy (and the plaintiff shareholder or member may actually be able to recover directly as discussed below). But what if there is neither a quantifiable injury to the entity nor a quantifiable benefit (for purposes of disgorgement) derived by the defendant? *Patton v. Nicholas* may provide a basis to argue that other equitable remedies are available when the defendant has acted for an improper selfish purpose.

Patton v. Nicholas provides a basis to argue that the "benefit to the defendant" for purposes of the third element of a claim for breach of fiduciary duty may consist of gaining an improper advantage that is not necessarily quantifiable and that corrective injunctive relief may be available to redress such a situation. As noted above, the supreme court's explanation of *Patton v. Nicholas* in *Ritchie v. Rupe* characterizes the minority shareholders' claim for failure to declare dividends in *Patton* as an actionable claim for breach of fiduciary duty owed to the corporation even though the court in *Patton* ultimately concluded that there was no actual loss suffered by the corporation (there being "no evidence that the misconduct of the [majority shareholder] reduced the net worth of the corporation or that it resulted in a smaller present net worth than would otherwise have existed") and no devaluation of the minority shareholders' stock since there was no market for the stock. *Patton*, 279 S.W.2d at 858. There was evidence to show that the majority shareholder in *Patton* intended eventually to acquire the minority shareholders' stock for much less than its value, and the court in *Ritchie v. Rupe* stated that Patton's use of "his control of the board for the malicious purpose of . . . preventing dividends and otherwise lowering the value . . . of the stock of the [minority shareholders]" was a breach of fiduciary duty to the corporation.

Ritchie v. Rupe, 443 S.W.3d at 884. The court in *Ritchie v. Rupe* further explained that *Patton* “demonstrates that when a corporate director violates the duty to act solely for the benefit of the corporation and refuses to declare dividends for some other, improper purpose, the director breaches fiduciary duties to the corporation.” *Id.* The appropriate remedy in *Patton* was an injunction order compelling payment of dividends by the corporation. Thus, *Patton* serves as precedent for creative equitable remedies for a breach of fiduciary duty to the corporation, whether or not the breach results in a measurable injury.

In *DeNucci v. Matthews*, No. 03-11-00680-CV, 2015 WL 1882469, ___ S.W.3d ___ (Tex. App.—Austin Apr. 23, 2015, no pet. h.), the minority shareholder asserted claims against the majority shareholder for fraud, breach of fiduciary duty, and shareholder oppression. On appeal, the minority shareholder conceded his shareholder oppression claim in light of the Texas Supreme Court’s opinion in *Ritchie v. Rupe*, but the court of appeals affirmed an award of damages in favor of the corporation based on the minority shareholder’s derivative claim for breach of fiduciary duty. Interestingly, the opinion reveals that the trial court also awarded the minority shareholder equitable relief that included reinstatement of the minority shareholder to the board of directors and an order to require the corporation to retain a bookkeeper and provide the minority shareholder access to the financial records. This equitable relief (which apparently was not challenged on appeal) is an example of one trial court’s willingness to employ equitable relief in favor of a shareholder in response to a breach of fiduciary duty to the corporation.

V. Minority Owners of Closely Held Corporations and LLCs Avoid Certain Procedural Requirements and May Recover Directly in Derivative Suits

The provisions of the Business Organizations Code governing derivative suits in the context of closely held corporations and LLCs not only relieve the plaintiff of certain procedural hurdles ordinarily present in a derivative suit (such as the pre-suit demand requirement), but also authorize the court to award the plaintiff direct relief for a claim that is derivative in nature “if justice requires.” Tex. Bus. Orgs. Code Ann. §§ 21.563, 101.463; *see also Sneed v. Webre*, No. 12-0045, 2015 WL 3451653, ___ S.W.3d ___ (Tex. May 29, 2015) (discussing the special statutory treatment of shareholder derivative claims asserted on behalf of closely held corporations). “Closely held” is defined for these purposes as fewer than 35 shareholders or members and not listed on an exchange or quoted in an over-the-counter market. Tex. Bus. Orgs. Code Ann. §§ 21.563, 101.463. If the derivative plaintiff shows that the corporation or LLC suffered actual damages, the plaintiff might argue that it is appropriate for the plaintiff to recover directly from the defendant a pro rata portion of the entity’s damages based on the percentage or portion of the plaintiff’s ownership in the entity.

As discussed above, based on equitable principles applicable in the case of a breach of fiduciary duty, the corporation or LLC on whose behalf a minority owner sues might be entitled to recover some sort of disgorgement from the defendant even if actual damages to the entity cannot be shown (i.e., based on the defendant’s improper benefit derived from breach of a fiduciary duty to the entity), and the plaintiff might seek a direct recovery of a share of the disgorgement under the derivative suit provisions that permit direct recovery “if justice requires.” Tex. Bus. Orgs. Code Ann. §§ 21.563(c), 101.463(c).

Furthermore, a plaintiff might argue that other types of direct equitable relief are appropriate to redress a breach of fiduciary duty to the entity based on principles of equity and the supreme court’s

recognition that an injunction order compelling payment of dividends was an appropriate remedy in *Patton v. Nicholas*. The supreme court in *Ritchie v. Rupe* did not rule out the possibility that a court-ordered buyout of the minority shareholder could be an appropriate remedy if the court of appeals on remand determined that the evidence was sufficient to support the minority shareholder's claim of breach of an informal fiduciary duty. See 443 S.W.3d at 892. If a court-ordered buyout might be available in a case involving breach of an informal fiduciary duty, perhaps there are circumstances in which it could be an appropriate remedy in a case involving derivative claims for breach of a formal fiduciary duty to the entity.

VI. The Relationship Between Corporate Shareholders or LLC Members May Constitute an Informal Fiduciary Relationship Under Particular Facts and Circumstances

Although shareholders do not generally owe one another fiduciary duties, the relationship between particular shareholders may constitute a confidential relationship giving rise to fiduciary duties when influence has been acquired and confidence has been justifiably reposed. *Flanary v. Mills*, 150 S.W.3d 785 (Tex. App.—Austin 2004, pet. denied) (stating that "[a] person is justified in placing confidence in the belief that another party will act in his or her best interest only where he or she is accustomed to being guided by the judgment or advice of the other party, and there exists a long association in a business relationship, as well as personal friendship"). This type of fiduciary relationship is often referred to as an "informal" fiduciary relationship as opposed to the "formal" fiduciary relationships that exist as a matter of law in relationships such as attorney-client, trustee-beneficiary, and director-corporation.

The supreme court in *Ritchie v. Rupe* acknowledged that an informal fiduciary relationship may arise from "a moral, social, domestic or purely personal relationship of trust and confidence." 443 S.W.3d at 874 n.27, 892 n. 63. The existence of an informal fiduciary relationship is ordinarily a question of fact. *Hoggett v. Brown.*, 971 S.W.2d 472, 488 (Tex. App.—Houston [14th Dist.] 1997, pet. denied). Fiduciary duties are not owed in business transactions unless the special relationship of trust and confidence predated the transaction at issue and arose separate from it. *Meyer v. Cathey*, 167 S.W.3d 327, 331 (Tex. 2005). Ordinary friendly and neighborly relationships do not alone demonstrate a special relationship of trust and confidence. See *Lindley v. McKnight*, 349 S.W.3d 113, 127-28 (Tex. App.—Fort Worth 2011, no pet.). Some courts of appeals have indicated that an informal fiduciary duty may be owed by a majority shareholder to a minority shareholder of a closely held corporation based on the exercise of domination and control by the majority shareholder. See, e.g., *Redmon v. Griffith*, 202 S.W.3d 225, 237 (Tex. App.—Tyler 2006, pet. denied). Courts in Texas have also acknowledged that an informal fiduciary relationship may arise between LLC members under particular circumstances. See *Guevara v. Lackner*, 447 S.W.3d 556 (Tex. App.—Corpus Christi-Edinburg 2014, no pet. h.); *Bazan v. Munoz*, 444 S.W.3d 110 (Tex. App.—San Antonio 2014, no pet. h.); *Vejava v. Levior Int'l, LLC*, No. 04-11-00595-CV, 2012 WL 5354681 *5 (Tex. App.—San Antonio Oct. 31, 2012, pet. denied); *Fed. Ins. Co. v. Rodman, LLC*, No. 3:10-CV-2042-B, 2011 WL 5921529 *3 (N.D. Tex. Nov. 29, 2011).

In *Ritchie v. Rupe*, the jury found that an informal fiduciary relationship existed between Rupe and the defendants, but the court of appeals did not reach the defendants' arguments relating to the claim for breach of informal fiduciary duty. Notably, the supreme court in *Ritchie v. Rupe* did not rule out the possibility that a court-ordered buyout of the minority shareholder could be an appropriate remedy if the court of appeals on remand determined that the evidence was sufficient to support the minority shareholder's claim of breach of an informal fiduciary duty. See 443 S.W.3d at 892.

VII. Minority Owners May Obtain a Receivership to Rehabilitate the Entity or Judicial Decree of Winding Up in Some Circumstances

Section 11.404 of the Business Organizations Code specifies grounds upon which a court may appoint a receiver to rehabilitate a domestic entity. *See* Tex. Bus. Orgs. Code Ann. § 11.404(a). The grounds upon which an owner may obtain a rehabilitating receiver are: (1) insolvency or imminent insolvency of the entity, (2) certain deadlock situations, (3) illegal, oppressive, or fraudulent actions on the part of the governing persons, or (4) misapplication or waste of the entity’s property. If one of these conditions is established, the court may appoint a receiver for the entity if the court concludes: (1) a receiver is necessary to conserve the property and business of the entity and avoid damage to interested parties, and (2) all other available legal and equitable remedies are inadequate. Thus, the circumstances under which a receiver may be appointed are limited to fairly dire situations. As discussed above, “oppressive” conduct has been defined by the Texas Supreme Court in *Ritchie v. Rupe* as an abuse of authority by management with intent to harm an owner in disregard of management’s honest business judgment. A rehabilitating receivership is not a very attractive remedy in many cases, but it may be effective relief in some instances. A rehabilitating receivership can ultimately lead to a liquidating receivership if a feasible plan for rehabilitation is not presented within one year of the appointment of the receiver. *See* Tex. Bus. Orgs. Code Ann. § 11.405(a)(3).

The receivership provisions of Sections 11.404 and 11.405 of the Texas Business Organizations Code apply to LLCs as well as corporations, but there is also a more direct route to court-ordered liquidation available in the LLC context. A member of an LLC may obtain a judicial decree of winding up (without a failed rehabilitating receivership) if the member establishes that it is not reasonably practicable to carry on the business of the LLC in accordance with the governing documents of the LLC. *See* Tex. Bus. Orgs. Code Ann. § 11.314(2). Deadlock is one situation in which courts in other jurisdictions have concluded that this standard is met under similar statutory provisions. This standard has not yet been the subject of judicial treatment in Texas in the LLC context. A case discussing a somewhat similar statutory provision in the limited partnership context is *Dunnagan v. Watson*, 204 S.W.3d 30 (Tex. App.–Fort Worth 2006, pet. denied) (discussing sufficiency of the evidence to support jury’s findings that partner’s actions made it not reasonably practicable to carry on partnership’s business with that partner).

VIII. Minority Owners May Enforce Contractual Obligations Owed to Them Under Contracts with Other Owners or the Entity

The supreme court in *Ritchie v. Rupe* stressed that minority shareholders may protect themselves by entering into shareholders’ agreements to protect their rights and obligations and that shareholders may assert claims in their own right if the conduct in question gives rise to a breach-of-contract claim. 443 S.W.3d at 881, 888 n. 55. The Business Organizations Code allows a corporation that is not publicly traded to be governed by a shareholders’ agreement entered into by all persons who are shareholders at the time of the agreement. *See* Tex. Bus. Orgs. Code Ann. §§ 21.101-21.109. Section 21.101(a) lists matters that may be included in such a shareholders’ agreement even though the agreed terms may be inconsistent with one or more other provisions of the corporate statutes. Section 21.714 of the Business Organizations Code similarly provides broad contractual freedom for the shareholders of a “close corporation” that has complied with the provisions of Subchapter O of Chapter 21 of the Business Organizations Code. *See* Tex. Bus. Orgs. Code Ann. §§ 21.701-21.732. Conventional shareholder voting agreements and buy-sell agreements are authorized by other provisions of the Business Organizations Code. *See* Tex. Bus. Orgs.

Code Ann. §§ 6.251-6.252, 21.210-21.213. In the post-*Rupe* era, minority shareholders would certainly be well-advised to enter into such agreements and to otherwise carefully negotiate the governing documents of the corporation along with employment contracts or other agreements necessary to obtain desired protections, but these matters are often neglected in closely held businesses. The statutory provisions authorizing various types of shareholders' agreements noted above all refer to "written" agreements. In some cases, it may be possible for a shareholder to establish that an enforceable oral agreement was entered into with other owners or the corporation with regard to particular matters.

In the LLC context, members have broad freedom to agree as they see fit regarding the affairs of the LLC in the company agreement. *See* Tex. Bus. Orgs Code Ann. §§ 101.001, 101.052, 101.054. Obviously, a minority member is best situated if there is a clear written company agreement protecting the member. Because a company agreement may be oral, however, a minority member of an LLC may have the opportunity to assert rights that have been the subject of an informal agreement among the members. *See* Tex. Bus. Orgs. Code Ann. § 101.001.

IX. Minority Owners May Have Common-Law and Statutory Fraud Claims in Some Cases

The supreme court in *Ritchie v. Rupe* pointed out that minority shareholders may be able to recover under common-law and statutory fraud remedies if the controlling directors and shareholders act fraudulently or manipulate the shares' value. 443 S.W.3d at 888 n. 56. Minority owners who believe they have been victimized in connection with their investment in the entity or a subsequent buyout or redemption should consider whether they may have common-law claims for fraudulent inducement or statutory claims for state or federal securities fraud (Tex. Rev. Civ. Stat. Ann. art. 581-33; 15 U.S.C. § 78j; 17 C.F.R. § 240.10b-5) or fraud in a transaction involving stock (Tex. Bus. & Com. Code Ann. § 27.01).

Appendix

Overview and Comparison of Prior Texas Case Law and Texas Law as Explained in *Ritchie v. Rupe*

<i>PRE-RITCHIE v. RUPE</i>	<i>RITCHIE v. RUPE</i>
<p><u>Recognition of Foreseeability , Likelihood, and Magnitude of Harm of “Squeeze-Out” or “Freeze-Out” Tactics by Directors and Majority Shareholders</u></p> <p>Courts of appeals since the seminal case of <i>Davis v. Sheerin</i> in 1988 have recognized the vulnerability of minority shareholders in closely held corporations with respect to “squeeze-out” and “freeze-out” tactics and have characterized the following as typical wrongdoing in shareholder oppression cases: termination of minority shareholder’s employment, denial of access to books and records, wrongful withholding of dividends, waste of corporate funds, payment of excessive compensation to majority shareholder, and wrongful lockout of minority shareholder.</p>	<p><u>Recognition of Foreseeability , Likelihood, and Magnitude of Harm of “Squeeze-Out” or “Freeze-Out” Tactics by Directors and Majority Shareholders</u></p> <p>Texas law should ensure that remedies exist to appropriately address harm suffered by minority shareholders due to abuse of power by those in control of closely held corporations. Types of conduct most commonly include (1) denial of access to corporate books and records, (2) withholding payment of, or declining to declare, dividends, (3) termination of employment, (4) misapplication of corporate funds and diversion of corporate opportunities for personal purpose, and (5) manipulation of stock values.</p>
<p><u>Definition of Oppression</u></p> <p>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</p> <p>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.</p>	<p><u>Definition of Oppression</u></p> <p>Directors 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.</p>
<p><u>Possible Remedies for Oppression</u></p> <p>Receivership (TBOC § 11.404) and other equitable remedies tailored to redress oppressive conduct such as court-ordered buyout, payment of dividends, etc.</p>	<p><u>Possible Remedies for Oppression</u></p> <p>Receivership (TBOC § 11.404)</p>
<p><u>Common-Law Cause of Action for Oppression</u></p> <p>Some courts of appeals applied oppression doctrine without relying on statutory authority.</p>	<p><u>Common-Law Cause of Action for Oppression</u></p> <p>None</p>

<p><u>PRE-RITCHIE v. RUPE</u></p> <p><u>Relief Available for Denial of Access to Books and Records</u></p> <p>Shareholder could pursue statutory rights and remedies (court-ordered access to books and records and recovery of costs and attorney’s fees) or, when conduct was determined to be oppressive under “reasonable expectations” or “fair dealing” tests, might obtain court-ordered buyout or other equitable relief.</p>	<p><u>RITCHIE v. RUPE</u></p> <p><u>Relief Available for Denial of Access to Books and Records</u></p> <p>Shareholder’s statutory rights and remedies (court-ordered access to books and records and recovery of costs and attorney’s fees) are adequate protection without creation of common-law cause of action for oppression.</p>
<p><u>Relief Available for Withholding Payment of Declared Dividends</u></p> <p>Shareholder could sue to recover payment as debt of corporation or, when conduct was determined to be oppressive under “reasonable expectations” or “fair dealing” tests, might obtain court-ordered buyout or other equitable relief.</p>	<p><u>Relief Available for Withholding Payment of Declared Dividends</u></p> <p>Shareholder’s right to recover payment as debt of corporation is adequate protection without creation of common-law cause of action for oppression.</p>
<p><u>Relief Available for Refusing to Declare Dividends</u></p> <p>When conduct was determined to be oppressive under “reasonable expectations” or “fair dealing” tests, shareholder might obtain court-ordered payment of dividends or buyout or other equitable relief (role of business judgment rule somewhat unclear; courts of appeals spoke of “balancing” shareholder’s reasonable expectations against corporation’s interest in managing its business).</p>	<p><u>Relief Available for Refusing to Declare Dividends</u></p> <p>Decision falls within discretion of board of directors if decision complies with formal fiduciary duties of care and loyalty owed to corporation. If director violates duty to act solely for corporation’s benefit by refusing to declare dividends for some improper purpose (e.g., malicious purpose of lowering value of minority shareholder’s stock), shareholder is entitled to relief “either directly to the corporation or through a derivative action” (with special rules applying to derivative suits in context of corporation with less than 35 shareholders.) If director’s decision is made for the benefit of the corporation, in compliance with duties of loyalty and care (acting in best interest of corporation generally fulfills duties), no relief is warranted even if there is incidental injury to one or more shareholders. “Refusal to pay dividends, paying majority shareholders outside the dividend process, and making fire-sale offers certainly can harm the corporation, for instance, by lowering the value of its stock.” Existing duties and remedies are sufficient to offer adequate protection regarding declaration of dividend without imposition of additional duties and remedies.</p>

<p><i>PRE-RITCHIE v. RUPE</i></p> <p><u>Relief Available for Termination of Employment</u> Court of appeals in one case declined to find termination of minority shareholder’s at-will employment oppressive, and court of appeals in another case declined to find reduction in compensation oppressive, but courts acknowledged that termination of at-will employment or reduction of compensation might be oppressive under some circumstances (and thus give rise to oppression remedies).</p>	<p><i>RITCHIE v. RUPE</i></p> <p><u>Relief Available for Termination of Employment</u> Short of “extreme circumstances,” termination of minority shareholder’s at-will employment is not actionable. Termination of at-will key employee that is improper—for no legitimate purpose, intended to benefit directors or individual shareholders at minority shareholder’s expense, and harmful to the corporation—may violate directors’ fiduciary duties to the corporation. These duties can be enforced in a derivative action (with special rules applying where corporation has less than 35 shareholders), or such a breach might be “oppressive” and justify appointment of rehabilitative receiver. Commitment to at-will employment doctrine compels conclusion that freedom to contract regarding employment relationships is sufficient protection of shareholder.</p>
<p><u>Relief Available for Misapplication of Funds or Diversion of Corporate Opportunities</u> Shareholder could sue derivatively on behalf of corporation for breach of duty of loyalty (with special rules applying where corporation has less than 35 shareholders) or, when conduct was determined to be oppressive under “reasonable expectations” or “fair dealing” tests, might obtain court-ordered buyout or other equitable relief.</p>	<p><u>Relief Available for Misapplication of Funds or Diversion of Corporate Opportunities</u> Misapplication of corporate funds and diversion of corporate opportunities are acts that breach the duty of loyalty and that may be redressed through an action brought directly by, or derivatively on behalf of, the corporation (with special rules applying where corporation has less than 35 shareholders). Because the potential harm is to the corporation and shareholders collectively, misconduct of this type does not require recognition of additional common-law remedy for individual shareholders.</p>
<p><u>Manipulation of Stock Values</u> When conduct was determined to be oppressive under “reasonable expectations” or “fair dealing” tests, shareholder might obtain court-ordered buyout or other equitable relief.</p>	<p><u>Manipulation of Stock Values</u> Claims based on acts of directors or those in control seeking to artificially deflate value of shares ordinarily belong to the corporation since individual shareholders have no separate and independent right of action for injuries to the corporation that result in the depreciation of the value of their stock. Directors’ fiduciary duties to the corporation provide protection for the minority when such conduct harms them in their capacities as shareholders. The fact that directors may endeavor to harm an individual shareholder’s interest without harming the corporation (i.e., without giving rise to damages recoverable in a derivative suit) does not justify adoption of a common-law rule that requires directors to act in the best interests of each individual shareholder at the corporation’s expense.</p>

<u>PRE-RITCHIE v. RUPE</u>	<u>RITCHIE v. RUPE</u>
<p><u>Availability of Remedy in Cases Where Duty to Act in Best Interest of Corporation Leaves “Gap” in Protection of Individual Minority Shareholder</u></p> <p>When conduct was determined to be oppressive under “reasonable expectations” or “fair dealing” tests, shareholder might obtain court-ordered buyout or other equitable relief (role of business judgment rule somewhat unclear; courts of appeals spoke of “balancing” shareholder’s reasonable expectations against corporation’s interest in managing its business). Oppressive conduct need not necessarily consist of “typical” “squeeze out” tactics to merit equitable relief.</p>	<p><u>Availability of Remedy in Cases Where Duty to Act in Best Interest of Corporation Leaves “Gap” in Protection of Individual Minority Shareholder</u></p> <p>Policy considerations do not weigh in favor of imposing a common-law duty on directors in closely held corporations not to take oppressive actions against an individual shareholder. “Although we do not foreclose the possibility that a proper case might justify our recognition of a new common-law cause of action to address a ‘gap’ in protection of minority shareholders, any such theory will need to be based on a standard that is far more concrete than the [‘reasonable expectations’ and ‘fair dealing’ definitions] of ‘oppressive.’”</p>
<p><u>Common-Law Duty Between Majority and Minority Shareholder</u></p> <p>Most courts of appeals have held there is no formal fiduciary duty owed by majority shareholder to minority shareholder, even in a closely held corporation. Texas Supreme Court reserved question in <i>Willis v. Donnelly</i>.</p>	<p><u>Common-Law Duty Between Majority and Minority Shareholder</u></p> <p>“This Court has never recognized a formal fiduciary duty between majority and minority shareholders in a closely-held corporation, <i>see Willis v. Donnelly</i>, 199 S.W.3d 262 (Tex. 2006), and no party has asked us to do so here. “The dissent’s contention that this Court should recognize a common-law duty between majority and minority shareholders, rather than between corporate controllers and the corporation, for [misapplication of corporate funds and diversion of corporate opportunities] is contrary to well-established law.”</p>
<p><u>Informal Fiduciary Duty Between Majority and Minority Shareholders</u></p> <p>An informal fiduciary duty may arise from a moral, social, domestic, or purely personal relationship of trust and confidence prior to and independent from the parties’ business relationship. As Justice Guzman observed in her dissenting opinion in <i>Ritchie v. Rupe</i>, “Texas courts of appeals have determined on a case-by-case basis whether majority shareholders owe an informal fiduciary duty to minority shareholders.[footnote omitted] A key factor weighing in favor of a fiduciary duty is the extent to which the majority shareholders dominate control over a closely held corporation.”</p>	<p><u>Informal Fiduciary Duty Between Majority and Minority Shareholders</u></p> <p>An informal fiduciary duty may arise from a moral, social, domestic, or purely personal relationship of trust and confidence prior to and independent from the parties’ business relationship. The jury found that the individual defendants owed Rupe an informal fiduciary duty and breached that duty. The court remanded to the court of appeals to resolve the defendants’ challenge to these findings and the question of whether a buyout is available as a remedy for such a breach. If these issues are resolved in Rupe’s favor, then the court of appeals will need to remand to the trial court for a redetermination of the value of the shares and whether the buyout is equitable in light of the impact that a buyout at that price will have on the corporation and its other shareholders.</p>