

The Texas Supreme Court, on June 20, 2014, issued its highly anticipated opinion in *Ritchie v. Rupe*, 2014 Tex. LEXIS 500 (Tex. 2014). *Ritchie* involved a claim by a minority shareholder in a closely held corporation under the Texas receivership statute, seeking to force the majority shareholders to buy-out the minority shareholder's interest in the corporation. The Texas Supreme Court, in a decision that curtails the rights and remedies of minority shareholders in closely held companies, rejected the minority shareholder's claim, holding as follows:

- "Oppression" by a majority shareholder under the receivership statute will only be found if the majority shareholder acts with the intent of harming the minority shareholder's interest and also harms the corporation itself;
- The Texas receivership statute only allows a judge to appoint a rehabilitative receiver, to the exclusion of all other remedies; and
- Texas does not recognize a common law tort for shareholder oppression.

*Ritchie* effectively eliminates legal protections that minority shareholders enjoy in most other jurisdictions. Accordingly, in the wake of *Ritchie*, a minority shareholder in a closely held Texas corporation must take great care in negotiating and drafting a robust shareholder agreement to govern their rights and remedies in the event that disputes arise.

### The Decision

Justice Boyd wrote the majority opinion in this 6 to 3 decision, concluding that the Texas receivership statute allows for the judicial appointment of a rehabilitative receiver only when necessary to protect a domestic entity's property and business if the managers or directors take actions that are "illegal, oppressive, or fraudulent." TEX. BUS. ORG. CODE § 11.404(a)(1)(C); former TEX. BUS. CORP. ACT art. 7.05.

Prior to *Ritchie*, Texas courts had recognized the right of a minority shareholder harmed by the actions of a majority shareholder to seek additional redress under this statute, including a court ordered "buy-out" of the minority shareholder's shares. The Supreme Court in *Ritchie* rejected this line of cases.

The Court first limited "oppression" under the Texas receivership statute to those instances when an entity's managers or 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." This definition of oppression notably incorporates the business judgment rule, giving great deference to actions by the majority stakeholders. Further, a minority shareholder may prevail under this definition only if the entity itself is harmed, in addition to the minority shareholder's own interests.

Second, the Court concluded that the Texas receivership statute authorizes only a single remedy: the appointment of a rehabilitative receiver when "necessary" to conserve the assets and business of the corporation and to avoid damage to parties at interest. In so doing, the Court explicitly rejected all other remedies, including the buy-out remedy expressly sought by the *Ritchie* plaintiff, and expressly recognized in previous Texas cases and other jurisdictions.

Third, the Texas Supreme Court refused to recognize a common law cause of action for minority shareholder oppression, further limiting the rights and remedies available to a minority shareholder of a closely held corporation.

### Practical Effect Of *Ritchie*

Thirty six other States have more expansive receivership statutes authorizing additional remedies including court ordered buy-outs and the appointment of liquidating receivers to remedy shareholder oppression. *Ritchie* makes it clear that Texas courts' authority is limited to the appointment of rehabilitative receiver to the exclusion of all other remedies. Furthermore, by limiting the definition of "oppression" under the statute to cases where a manager or director *intends* to harm the interests of the minority shareholder in such a way that *also causes harm to the entity itself*, it remains to be seen in what circumstances—if any—a minority shareholder could actually prevail on a claim under the Texas receivership statute. After all, "freeze outs" and "squeeze outs," while obviously detrimental to a minority stakeholder's interest, may actually benefit a closely held corporation.

In light of *Ritchie's* curtailment of the rights and remedies, an individual or entity invested in or seeking to invest in a minority position in a Texas closely held corporation must guarantee their own legal protection by way of a robust and tailored shareholder agreement—minority shareholders should consider buy-sell, first refusal, redemption, and like provisions. The shareholder agreement must be central to anyone considering investing as a minority shareholder, and those currently holding minority positions should take this opportunity to review the rights and remedies to which they are entitled.

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