

# Drafting Shareholders' Agreements in a *Post-Ritchie v. Rupe* World

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"OK, I'm now going to read out loud every single slide to you, word for word, until you all wish you'd just die."

# Minority Shareholder Oppression Suits

- The majority seeks some advantage, financial, operational or otherwise above and beyond lawful rights flowing from his majority.
- Dishonesty in conduct, in purpose or, in both, exists.
- One or more assets of the Company are misused by the majority for its sole or disproportionately individual benefit.
- The conduct violates a fiduciary duty that the instigator owes to the Company itself.

# *Ritchie v. Rupe*

- Texas Supreme Court's decision - *Ritchie v. Rupe*, 443 S.W.3d 856 (Tex. 2014),
  - No common law COA for oppression exists in Texas law
  - No compulsory buy-out remedy or damages exists under TBOC--remedy is limited to a rehabilitative receivership
  - Old test for “oppressive” conduct discarded:

[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.
  - Remaining related causes of action are found sufficient

# *Ritchie says “Handle this by Agreement”*

- Types of Agreement we will talk about
  - Charter
  - Bylaws
  - Shareholder’s agreements
  - LP and LLC agreements
  - Voting Agreements
  - Proxies
  - Powers of attorney

# Failure to Declare a Dividend

- Most common complaint. Preserved in *Ritchie*
- Claimant argues that the Company has developed a surplus profit which should be distributed. Instead, the director, officer or manager has misappropriated a Company asset, the dividend, by putting it in his own pocket to the exclusion of minority shareholders. Claimant argues that management suffers from a conflict of interest and has engaged in self-dealing by setting exorbitant salaries or benefits.

# Planning Options

- Charter / Bylaws – Specify how dividends declared.
- Independence of the decision maker setting salary – Independent Compensation Committee.
- Transparency to shareholders - Information Rights in Shareholders Agreement.
- Dispute mechanism - Any dispute arising among shareholders concerning the compensation of any officer, director or manager shall be submitted to third party HR expert/arbitrator.

# “Freeze Out”

- A freeze out is a concerted effort by the majority to remove one or more minority shareholders from management of the entity, the stream of information produced about the entity, or both. Common methods...
  - Termination of shareholder employment in a closely held company.
  - Removal from the premises of operation.
  - Refusal to provide access to Company books and records.

# Planning Options

- Right of first refusal
- Right of first refusal in event of termination of employment
  - Purchase price penalty for termination with cause
  - No contract right to employment
  - Information rights
  - Board representation
  - Board observer rights
  - Confidentiality provisions

# “Squeeze Out”

- A “Squeeze Out” is a Freeze out with the added step of a “compelled” buy-out
  - Majority may make de-minimis offer to purchase minority interest, knowing a better offer for the entity as a whole is coming
  - Majority may make cash call, knowing that recently fired manager/minority cannot afford it and thus dilute her interest
  - Majority may issue a superior class of shares as alternative means of dilution.

# Planning Options

- Stock transfer restrictions
- Call right (setting valuation methodology is critical)
- Drag-along right
- Business opportunity clause (either must offer or need not offer)
- Preemptive rights
- Special voting rights – blocking or veto right (No sale without minority shareholder approval)

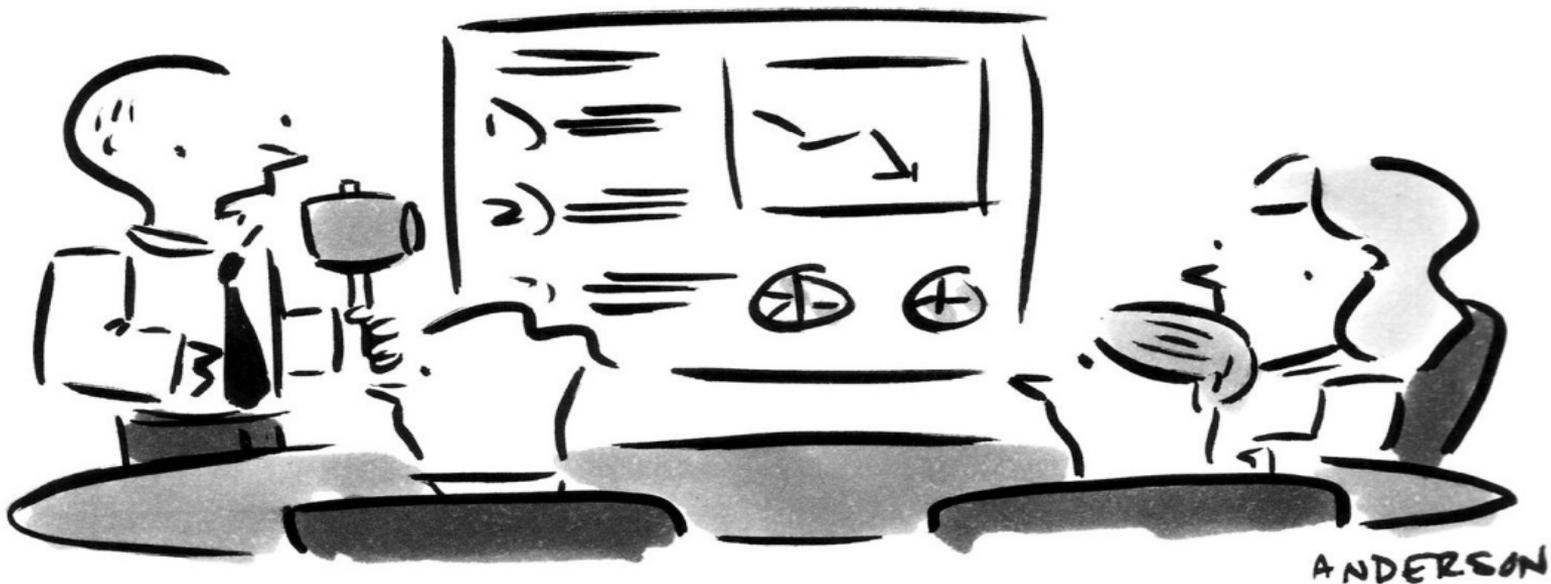
# “Free-for-All”

- What we refer to as a “business divorce.” Most commonly seen in small business and practice groups. May include:
  - Removal of corporate funds or repositioning to accounts controlled by one faction.
  - Diversion of Company business directly or to a newly formed company.
  - Deliberate harmful actions to opposing shareholder group.

# Planning Options: Free for All

- Ordinary Planning Options are ineffective. The parties are concertedly refusing to use or refer to their agreements.
- Only real remedy is injunctive relief until parties can be brought to the table.
- Best advice may be for majority to “lock down” the corporation pending injunctive relief (preserve the status quo pending an injunction).

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“Of course I can’t in good conscience condone this, so one of you will have to knock me unconscious first.”

# Questions

- For more information, please contact:

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