

Complex Litigation & E-Discovery

Minority Oppression Claims: A Primer on Acting, Standing, Remedies and Valuation

State protection of the interests of minority shareholders

By Scott I. Unger

The Minority Oppression or Deadlock Statute, N.J.S.A. 14A:12-7, was enacted to protect minority shareholders of closely held companies. By creating the Minority Oppression Statute, the New Jersey Legislature recognized the need to protect the interests of minority shareholders from disputes which inherently arise as a result of the close relationships between the shareholders, the relatively small size of the closely-held company, and the limited number of people who might be interested in buying an interest in the company. This article generally explores: (1) what constitutes actionable minority oppression; (2) who has standing to assert minority oppression claims; (3) the remedies available to oppressed parties; and (4) the meaning of “fair value” with respect to a court-ordered buyout of a minority shareholder’s interest in the closely held company.

In *Brenner v. Berkowitz*, 134 N.J. 488

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(1993), the New Jersey Supreme Court identified what actions and inactions could constitute actionable minority oppression. In that seminal case, the New Jersey Supreme Court endorsed the concept of testing for oppression by examining the “reasonable expectations” of the minority shareholder and the effect of the defendant’s actions on these expectations. Under that approach, the oppression to which a vulnerable minority shareholder may be subjected is not limited to illegal or fraudulent actions (“‘illegality’ and ‘fraud’ as used in the statute are not meant to be synonymous with ‘oppression’”). Instead, the test of oppression must focus on the minority shareholder’s “reasonable expectations” and whether the actions of the defendant have frustrated those expectations. See *Bonavita v. Corbo*, 300 N.J. Super. 179, 194 (Ch. Div. 1996).

The focus on “reasonable expectations” rather than a search for “wrongful” conduct is consistent with the approach taken by most courts and commentators. *Bonavita*, 300 N.J. Super. at 194 In *Bonavita*, the court stated:

One of the most significant

trends in the law of shareholder relationships in recent years is the increasing willingness of courts to look to the reasonable expectations of shareholders to determine whether “oppression” or similar grounds exist as a justification for involuntary dissolution or another remedy.

The increasing use of the reasonable expectations standard reflects a move away from an exclusive search for egregious conduct by greater consideration of the position of the complaining shareholder, even if no egregious conduct by the controllers can be shown.

Hence, under New Jersey law, the complainant need not show that the majority shareholders acted in an unlawful, fraudulent, oppressive or unfairly prejudicial manner in order to trigger the protections under N.J.S.A. 14A:12-7. Rather, all that needs to be shown is that the majority interfered with the minority’s “reasonable expectations as a shareholder.”

Generally, minority shareholders of closely held companies (less than 25 shareholders) have standing to assert a minority oppression cause of action if they can demonstrate that their “reasonable expectations” have been frustrated or the majority has acted fraudulently, illegally or oppressively towards the minority. In addition to actual minority shareholders, courts have held that “majority shareholders,” “ben-

eficial shareholders” and “nominal owners” also have standing to assert minority oppression claims. See *Berger v. Berger*, 249 N.J. Super. 305, 313 (Ch. Div. 1991) (holding that a “beneficial owner” or “nominal owner” has standing to assert a claim under the minority oppression statute).

The case of *Berger v. Berger* involved a nonminor plaintiff who owned a majority interest in a closely held, family-owned toy company. The plaintiff’s majority interest was held in trust. The trust was controlled by the plaintiff’s father and step-mother who were the co-defendants. In response to the plaintiff-son’s complaint, the defendants filed a pre-answer motion to dismiss for failure to state a cause of action upon which relief can be granted pursuant to Rule 4:6-2(c). In their pre-answer motion to dismiss, the defendants argued that the plaintiff — merely a beneficial owner of the company’s stock — could not maintain his action to dissolve the closely held company because he did not have standing. In the alternative, the defendants asserted that the son was not a “minority shareholder” under the statute because he owned 98 percent of the company’s stock.

The court recognized that the issues raised by the defendants’ motion were of first impression. After carefully considering both sides’ arguments, the court held that the plaintiff as a “nominal” or “beneficial” owner had standing to assert the minority oppression claim. In addition, the court held that despite the fact that the plaintiff was actually the “majority shareholder” (because he owned 98 percent of the closely-held company in trust), he nevertheless had standing to

assert the oppression claims because he was a “dissenting shareholder.”

Provided the appropriate facts and circumstances exist, the court’s holding in *Berger* has opened the door for majority, beneficial and nominal owners of closely-held companies to assert claims under the Minority Oppression statute.

The Minority Oppression Statute offers a variety of temporary and final remedies to oppressed shareholders. Courts enjoy broad equitable powers in which they are given vast discretion and flexibility to fashion equitable remedies. Those remedies have included, but are not limited to, the following types of relief: the removal of a director, officer or employee; the restoration of a wrongfully-removed director, officer or employee; the appointment of a special fiscal agent to make recommendations to the court; the appointment of dissolution; a court-ordered buyout by one party of the other’s interest; an auction by the parties; the sale to a third party; the appointment of a “receiver” or provisional director; dissolution of the company; the court-ordered buyout; a court-ordered auction; and/or the court-ordered sale of the company to a third party.

When deciding which remedy or remedies to employ, a court should consider the degree of harm to the shareholders, the effect on employees of the closely-held company, the potential loss of good will, and the potential harm to innocent third parties, together with the seriousness of the alleged oppression. See, *Brenner v. Berkowitz*, 134 NJ 488. Moreover, the court should weigh and consider the oppressed minority share-

holder’s reasonable expectations compared to the majority’s ability to exercise its business judgment and effectively run the company. *Muellerberg*, 143 N.J. 168. In most cases, courts will order the buyout of the complaining minority shareholder’s stock. Because of the negative effects it may have on the corporation, its employees and other innocent third parties, courts rarely order the dissolution of the closely-held company.

Because courts typically order a buyout of the oppressed minority shareholder’s interest, the single most important issue in an oppression case is the valuation of the complaining shareholder’s interest in the closely-held company. The rule of thumb in New Jersey is that in performing a statutory appraisal for purposes of determining the “fair value” of a minority shareholder’s interest in a closely-held company, N.J.S.A. 14A:11-1 to -11, or for valuing shares in a court-ordered buy-out resulting from an oppressed shareholder situation, N.J.S.A. 14A:12-7(1) (c), neither a marketability nor a minority discount should be applied absent “extraordinary circumstances.” *Balsamides v. Protameen Chemicals, Inc.*, 160 N.J. 352 (1999); *Lawson Mardon Wheaton, Inc. v. Smith*, 160 N.J. 383 (1999). This is an important nuance in minority oppression law, as these “discounts” generally are inapplicable absent extraordinary circumstances. In any event, a Court presiding over a minority oppression case generally will value the minority shareholder’s interest and accord such appropriate relief that is fair and equitable to all parties involved in the dispute. ■