

LEGALLY SPEAKING

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Are You An Oppressed Minority Shareholder? You Do Have Protection

New Jersey has some of the best laws in the country to protect minority shareholders from oppressive majorities in “close corporations” (defined by statute as one having 25 or less shareholders). Under this law, minority shareholders have the ability to obtain relief in the New Jersey courts if those in control of the company have acted fraudulently, illegally, mismanaged the company, abused their authority, and/or have acted oppressively or unfairly toward the minority shareholders in the company.

These laws were enacted to protect shareholders in small and mid-sized companies who are vulnerable to the whims of the majority and have no ability to sell their shares and get fair value for them in the open market.

The fact patterns in these cases often have common themes. Family-owned businesses are a common one. Another are ones involving long-term employee stock purchases. The stakes are high and passions run deep.

Usually, the beginning is good. Everyone is happy. Everyone has ownership and gets a piece of the action. Times are good. Then inevitably, certain shareholders take or gain control of the company by virtue of their share numbers and take action for what might be their own personal

good but not for the good of the company or detrimental to the minority shareholders.

Oppression can take many forms. It could be shown where the majority awards themselves excessive compensation. They may furnish inadequate dividends or misapply and/or waste corporate funds.

Another measure of oppression is whether the fair or reasonable expectations of the parties have been met. A party may reasonably expect that his or her employment would be secure or that they would have meaningful participation in the management of the business, or they may be completely frozen out from the operation. The possibilities are endless and the results are devastating to the minority.

Fraudulent and illegal acts alone without any additional showing of oppression can trigger the remedies under these laws. Furthermore, there is no requirement that the fraudulent or illegal acts be ongoing at the time of trial for these laws to apply.

Once a court gets involved in the case, a Chancery Division judge has the ability to order variety of potential relief to benefit minority shareholders. This relief may include the appointing of a custodian or appointment of

provision directors. The purpose of this is to have someone handle and manage the affairs of the corporation until the court orders otherwise. This custodian or provision director would periodically report to the court and shall, if directed, present recommendations for the appropriate disposition of the matter.

A more drastic step is for the court to order dissolution of the company. This would happen if the court finds this option is in the best interests of the shareholders of the company. The court would necessarily determine whether the corporation is operating profitably but the court would not necessarily deny entry of such a judgment merely because the company was operating profitably.

A common remedy and the type frequently favored is a buy-out with the court ordering the sale of a party's stock to either the moving shareholder or to the corporation.

A critical issue in any buy-out in one of these cases is determining fair value for the selling shareholder's interests. Although there frequently is a valuation formula established in a shareholder agreement, this would not be binding on a court in an action brought under this statute.

There are a variety of valuation techniques to establish the value of a party's shares. Unfortunately, as lamented by our courts, valuation in this realm has been described as more akin to art than science. Techniques that are generally accepted in the financial community are considered for these purposes. Frequently used methods are the excess earnings method, discounted cash flow earnings method, the market approach and the Delaware Block approach, just by way of example.

Regardless of the valuation technique employed, the purchase price of any shares sold

is the fair value of the shares on the date of the commencement of the action.

Furthermore, courts look not only to the book value of the shares, but may also take into consideration good will, actual profits and discounting of the minority's interest. The courts are also empowered to make adjustments to achieve equity among the parties and may even uphold other contractual arrangements between the parties.

Finally, at the end of the matter, if the court determines that a party acts arbitrarily, vexatiously, or otherwise not in good faith, it may award reasonable expenses, including attorney's fees and expenses incurred in connection with the action, to the injured party. In addition, a showing of bad faith is not even required to award a selling shareholder's attorney's fees, but just merely a showing that the shareholder oppression took place.

A minority shareholder often feels like he or she has no way out or no remedy when being oppressed. As the above demonstrates, the New Jersey Legislature has implemented laws designed to protect these vulnerable parties when they need it most.

Please call us today for a free consultation if you believe that you believe that you have been treated unfairly as a minority shareholder.

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