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# Equitable Remedies Are Available for All Minority Owners

## No matter the type of oppression, equity can provide a solution

By David White

Oppression of minority owners in businesses is broadly recognized as conduct that "frustrates the reasonable expectations" of the minority owner. For example, in *Muellenberg. v. Bikon Corp*., 143 N.J. 168, 179 (1996), the majority owner's concerted efforts to marginalize the minority shareholder's management, including declaration of a dividend that undercut the corporation's functioning and curtailing his day-to-day authority, constituted oppression. In *Brenner v. Berkowitz*, 134 N.J. 488, 506 (1993), it was found that misconduct that harms the minority shareholder's interests in the company, such as permitting tax-free sales, paying employees without tax compliance and fraudulently placing nonunion workers in union positions, constituted oppression.

In determining whether a shareholder's expectations are reasonable and whether the corporation or controlling shareholders or directors unreasonably thwarted them, courts consider even the nonmonetary expectations of the shareholder. Indeed, the Supreme Court has noted that "termination of a shareholder's status as an employee is a much more common means of oppression in a close corporation than is infringement of a shareholder's status as a shareholder." *Brenner*, 134 N.J. 509. Because majority shareholders have the power to dictate to the minority the manner in which the corporation is run, a minority shareholder in a close corporation becomes vulnerable when dissension develops. *Bostock v. High Tech Elevator Indus.*, 260 N.J. Super. 432, 443-44 (App. Div. 1992).

Minority oppression is typically manifested by a "freeze-out," which has been defined in the corporate setting as "a manipulative use of corporate control or inside information to eliminate minority shareholders from the enterprise, or to reduce to relative insignificance their voting power or claims on corporate earnings and assets or otherwise deprive them of corporate income or advantages to which they are entitled." 2 O'Neal, *Close Corporations*, Section 8.07, at 43 (2d ed. 1971). The vulnerability of minority shareholders is exacerbated by the illiquidity of their financial stake in the company. They cannot dissolve the company at will, nor can they sell their shares on the open market like shareholders in a publicly held corporation. As a consequence, a shareholder challenging the majority in a close corporation is on the horns of a dilemma. The shareholder can neither profitably leave nor safely stay with the corporation. In reality, the only prospective buyer often turns out to be the majority shareholder. This inability of minority shareholders to withdraw from the venture on their own terms exposes them to exploitation by controlling shareholders that defeats their reasonable expectations, financial and otherwise.

In the close corporate setting, the Minority Oppression Statute, N.J.S.A. 14A:12-7, part of New Jersey's Business Corporation Act (BCA), allows a court to grant relief when controlling shareholders have acted "fraudulently or illegally, mismanaged the corporation, or abused their authority as officers or directors or have acted oppressively or unfairly" toward a minority shareholder. N.J.S.A. 14A:12-7(1)(c) provides a range of remedies including a court-ordered purchase or sale of a shareholder's stock in the corporation. The standard of valuation for a buy-out is "fair value." N.J.S.A. 14A:12(8) (a). "Fair value" is a legislatively mandated and judicially crafted concept designed to compensate the oppressed shareholder for what has been taken from him. It

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is not synonymous with "fair market value." Fair value excludes discounts, such as minority discounts for lack of control or marketability discounts for lack of liquidity that would otherwise decrease the fair market value of the oppressed shareholder's interest. The rationale for these "fair value" adjustments is that oppressors could actually benefit from their actions, buying out the oppressed minority's interest at a discount.

Prior to March 2014, the Limited Liability Company Act, N.J.S.A. 42:2B-1 et seq, did not contain comparable minority oppression provisions. The closest analog in the LLC Act was N.J.S.A. 42:42B-38, which controlled withdrawal by a member. The provision assumed a voluntary dissociation rather than an oppressively forced withdrawal, and provided the standard of value for the withdrawing interest. Although the LLC Act defined valuation as "fair value," the statutory definition was further defined to include "all applicable discounts," such as those for liquidity, control or size of holdings. N.J.S.A. 42:2B-39. As a valuation discount may typically reduce a shareholder's interest by 25 to 30 percent, the diminishing effect on an oppressed member's value could be significant. To avoid these reductions, and in view of the parallels in the predicaments of oppressed owners in the close corporate and LLC settings, courts had begun to "import" oppression remedies from the BCA to LLC disputes. Litigants argued that since the LLCA preserved rules of law and equity (N.J.S.A. 42:2B-67), the common features of oppression in corporate and LLC settings, together with the LLC Act's silence on oppression remedies, justified drawing on the corporate, minority shareholder statute to craft relief.

That approach came to a halt on Aug. 1, 2013, when the Appellate Division decided *Tutunikov v. Markov*, A-1827-10T3. In that case, the trial court, accepting the comparison between oppression of shareholders and members, applied the minority shareholder provisions of the BCA to an oppression claim by minority members in a limited liability company. The Appellate Division rejected the approach and held that the minority shareholder's act was inapplicable to LLCs. As of March 18, resorting to analogy for LLC oppression is no longer necessary. New Jersey has adopted the Revised Uniform Limited Liability Company Act, which includes a specific minority oppression provision, N.J.S.A. 42: 2C-48a(5)(b). That section authorizes relief to minority members on the grounds that the managers or controlling members have acted "in a manner that is oppressive and was, is or will be directly harmful to the applicant." The statute provides that the court may "order the sale of all interests held by a member who is a party to the proceeding to either the limited liability company or any other member who is a party to the proceeding" where it determines that such an order would be fair and equitable to all parties under all of the circumstances of the case. This enactment has created by statute the oppression remedy litigants previously sought to craft by analogy to the principles governing close corporations.

Partnerships in New Jersey are governed by the Revised Uniform Partnership Act (RUPA), N.J.S.A. 42: 1A-1. RUPA does not contain specific oppression provisions, however, it does establish a standard of fiduciary care among partners and the partnership, and authorizes intrapartnership suits for breaches of that duty or breaches of the partnership agreement that cause harm to the business. N.J.S.A. 42:1A-25. As in the case of the previous LLC Act, RUPA preserves the principles and remedies of law and equity to the extent they were not "displaced" by its particular provisions. N.J.S.A. 42: 1A-5.

In this framework, remedies for partnership oppression are cognizable, at least as claims for breach of fiduciary duty. *Muscarelle v. Castano*, 302 N.J. Super. 276 (App. Div. 1997). *Muscarelle* arose in the context of a limited partnership, construed under RUPA pursuant to N.J.S.A. 43:2A-3, which applies the partnership statute where the limited partnership act is silent. In *Muscarelle*, the partners disagreed over the disposition on dissolution of the partnership's real estate. The partnership agreement required a 67 percent vote to sell property, however the majority owned only 60 percent and contended that their majority vote should determine the outcome. Even though the partnership statute did not provide for the appointment of a receiver, the trial court appointed a receiver to resolve the dispute. The appellate court began by observing that "[i]t is axiomatic that the relationship of copartners is one of trust and confidence, calling for the utmost good faith, permitting of no secret advantages or benefits." It upheld the Chancery Division's invocation of equitable remedies, citing a case regarding its "residual authority." In no uncertain terms, the appellate court wrote that "the Chancery Division may, and should, take appropriate measures where the majority threatens to wholly frustrate the legitimate expectations of the minority." The Appellate Division reasoned that that equitable relief is "one of the weapons in the Chancery Division's arsenal that can be used to combat minority oppression."

Deriving remedies for oppression in partnerships from the fiduciary duties of partners should come as no surprise. Chancery courts retain an inherent common-law power to achieve equity in this setting. *Brenner*, 134 N.J. at 512-13. That notion comports with the equitable maxim that "wherever a legal right has been infringed a remedy will be given." *Walensky v. Jonathan Royce Int'l*, 264 N.J. Super. 276, 281 (App. Div. 1993). As the court wrote there, "where 'oppression' has been clearly established but the concerned statutory provisions fail to afford the injured parties adequate relief, it cannot seriously be questioned that equity will not suffer a wrong without a remedy."■