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# Closely Held Family Businesses: What Happens When the Family is No Longer Close

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Consider the case of a closely held family business started by a parent or grandparent. Hard work, sacrifice, and significant finances went into starting the business, building it, and overseeing profitable years. Now, the business is being turned over to the next generation, a process that can be fraught with disagreement regarding the transition and succession planning. Conflict develops as family members fail to see eye-to-eye on who can and should run the company. Each family member may have an ownership interest in the business; however, the more dominant family member may abuse his or her power, make decisions without involving other family members, and take control of the company. Can the controlling family member exclude or 'freeze out' the other members? What are the rights and remedies of the family members who do not control the company?

## The Rights of Oppressed Minority Shareholders

In 1968, New Jersey enacted the minority oppression statute, codified at N.J.S.A 14A:12-7. The act, as amended in 1988, was designed to solve problems peculiar to "close corporations," corporations having "25 or less shareholders."[1] It was enacted to help address the concerns of powerless "minority" shareholders, who had been left in "freeze out" situations or where those in control acted fraudulently or illegally, mismanaged the corporation, abused their authority, or otherwise acted oppressively or unfairly toward one or more of the minority shareholders.[2]

In freeze out situations, the act gives a minority shareholder a remedy where he or she has been eliminated from the company, where his or her voting power has been drastically reduced, where the shareholder has been otherwise deprived of the ability to participate in the decisions of the company, or where he or she is deprived of corporate income or advantage to which he or she is entitled.[3] The act presently embodies a legislative determination that freeze out maneuvers in a close corporation constitute an abuse of power.[4]

The act, however, is not rendered inapplicable where a plaintiff is the majority shareholder. A majority shareholder not in control of the company may seek relief under the act.[5] The real concern of the statute, rather than the amount of stock held, is "protection from the abuse of *power*."[6] "[T]he question of whether one is a minority shareholder should not 'be determined through a mechanistic count of stock ownership percentages…but rather by a qualitative evaluation of the actual control a particular shareholder may exert on a closely held corporation..'"[7] As such, where a shareholder owns the majority interest in the corporation, an action under the act may be brought by the majority shareholder where such an individual cannot reach a majority vote and, consequently, does not have control of the company.[8] Under this scenario, the court will rule on the plaintiff's status based on a qualitative examination of his or her power in that corporation. Thus, a non-controlling majority member in a closely held business may also seek relief under the act to protect his or her interest and/or to enjoin the controlling member from any oppressive and/or improper actions.

## Deadlock Under the Shareholder Oppression Statute

What happens when the shareholders cannot agree on significant decisions or there is deadlock on major issues concerning the operations of the corporation? Deadlock can be proven if a party can show that directors "are unable to effect action on one or more substantial matters respecting the management of the corporation's affairs."[9] Where there is deadlock, a court can take remedial action.

## Showing Oppression Under the Shareholder Oppression Statute

"[T]he intent and purpose of N.J.S.A. 14A:12-7 is to prevent abuse and oppression by those in control of a closely-held corporation upon those with inferior interests" or power.[10] A primary "measure of oppression in the small corporation is whether the fair expectations of the parties have been met."[11] "When personal relations among the participants in a close corporation break down, the 'reasonable expectations' that participants had, for example…*that they would enjoy meaningful participation in the management of the business*, become difficult, if not impossible, to fulfill."[12] When expectations involving the management of the corporation are not met, the act affords relief to the oppressed shareholder.

## Remedies Under the Act

The act provides specific statutory remedies including, among others, injunctive relief, the appointment of a receiver, the purchase of a shareholder's stock, or dissolution. Courts are not limited to the statutory remedies but have a wide variety of other remedies available to them. The statute also permits the court to award counsel fees and costs to any party if the court finds the other party acted "arbitrarily, vexatiously, or without good faith."[13]

## Action in Equity

The superior court, Chancery Division, general equity part has jurisdiction of all actions in which the plaintiff's primary right or principal relief is *equitable* in nature. One of the many benefits of an action in equity is that the court has the discretion to adapt the relief to the circumstances of the case and may compel or restrict the actions of one party. Indeed, the general equity part of the superior court may be best equipped for efficient disposition of a corporate deadlock or oppressed minority shareholder action because the court has the ability to order dissolution, to appoint a custodial receiver, fiscal agent, or provisional director, or to fashion another appropriate equitable remedy.

Procedurally, a complaint or a verified complaint and order to show cause (OSC) may be filed to initiate the case. If injunctive relief is sought, an emergent application may be made by filing an OSC *with temporary restraints*. An initial hearing regarding the temporary restraints will likely be required within a few days of filing of the action, pursuant to Rule 4:52-1(a). On the return date of the OSC, the court may impose a preliminary injunction that will last until final disposition of the case or until the defendant succeeds in moving for a dissolution of the restraints.

Where a family member finds him or herself a party to an oppressed minority shareholder suit, a decision regarding the control, and/or abuse of that control, or deadlock can be made on the return date of the OSC, pending a full resolution of all issues through litigation. An application to dissolve or modify a preliminary injunction may require more than a motion return date. The court may schedule a plenary hearing to consider the sworn testimony of accountants, financial advisors, and others to resolve any factual disputes and decide how to proceed.

## The Limited Liability Company and the Minority Oppression Statute

Increasingly, many closely held businesses are being structured not as close corporations but as limited liability companies (LLCs). As a result, one might question whether a minority owner of an LLC has the same protections against oppression and whether the minority oppression statute can afford relief to LLC minority owners.

When the state Legislature first enacted the New Jersey Limited Liability Company Act (LLCA), codified at N.J.S.A. 42:2B-1 *et seq.*, it did not incorporate the minority oppression contained in the New Jersey Business Corporation Act (BCA), codified at N.J.S.A. 14A:12–7(1)(c). Therefore, minority members of LLCs did not have an equivalent minority shareholder oppression cause of action. The problems common to both the corporation and the LLC have served as the basis for some courts to fill gaps in the LLCA using the BCA.[14] The New Jersey Appellate Division, however, has expressly held that LLCs in New Jersey are governed solely by the LLCA.[15] The District Court of New Jersey reached a similar conclusion and refused to permit a former member of an LLC to bring a claim of shareholder oppression under N.J.S.A. 14A:12–7(1)(c), noting that the court was "unaware of any case in which a member of a New Jersey limited liability company was able to successfully bring a cause of action under the shareholder oppression act."[16]

On Sept. 19, 2012, Governor Chris Christie signed the Revised Uniform Limited Liability Company Act RULLCA, codified at P.L. 2012, c.50, N.J.S.A. 42:2C 1

through 42:2C94, which applies to any LLCs formed on or after March 18, 2013, and all pre-existing LLCs beginning on April 1, 2014. The RULLCA affords minority members of an LLC several remedies for deadlock and oppression, including dissolution, appointment of a custodian, or sale of a member's LLC interest. Thus, where an LLC's managers or controlling members are acting illegally, fraudulently, or oppressively to another member, LLC members will be able to seek comparable relief under the RULLCA once the new statute takes effect. In the meantime, however, LLC minority owners will have little recourse, as the Appellate Division recently reiterated that "[g]iven the lack of an oppressed member provision in the LLCA, our holding in *Denike* and the Legislature's recent actions [enacting the Revised LLC Act with its oppressed member provision], we think it clear that the BCA's oppressed shareholder provisions have no application to an LLC."[17]

## Conclusion

The minority oppression statute can serve as a powerful tool for those family members who find themselves powerless, oppressed, frozen out of decisions, or otherwise treated unfairly by another family member who is in control of the corporation. An action in the general equity part of the superior court via an order to show cause (with or without temporary restraints) may be the most efficient and effective source of relief for such a party, given the court's ability to fashion an equitable remedy. While the RULLCA now provides remedies for deadlock and oppression, oppressed minority members of LLCs existing prior to March 18, 2013, will have to wait until April 1, 2014, (when the new statute takes effect) for any relief, as the Appellate Division has made clear that the BCA's oppressed member provision does not extend to LLCs. ■

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## Endnotes

1. N.J.S.A. 14A:12-7 (1)(c).
2. *Id.*
3. *Id.*
4. *Exadaktilos v. Cinnaminson Realty Co., Inc.*, 167 N.J. Super. 141, 154 (Law Div. 1979), *aff'd*, 173 N.J. Super. 559 (App. Div.), *certif. denied*, 85 N.J. 112 (1980).
5. *Bonavita v. Corbo*, 300 N.J. Super. 179, 187 (Ch. Div. 1996).
6. *Id.*
7. *Id.* (*quoting Berger v. Berger*, 249 N.J. Super. 305, 315 (Ch. Div. 1991)).
8. *See Balsamides v. Protameen Chemicals, Inc.*, 160 N.J. 352, 371 (1999).
9. N.J.S.A. 14A:12-7(6).
10. *Berger*, 249 N.J. Super. at 316.
11. *Muellenberg v. Bikon Corp.*, 143 N.J. 168, 180 (1996).
12. *Id.* (emphasis added).
13. *Belfer v. Merling*, 322 N.J. Super. 124, 146 (App. Div.), *certif. denied*, 162 N.J. 196 (1999).
14. *See Percontino v. Camporeale,* No. BER-C-5-05, 2005 WL 730234, at *3 (Ch. Div. March 24, 2005) (holding the court had the ability to appoint a receiver in the case of a limited liability company, regardless of the absence of any specific provision within the LLCA).
15. *Denike v. Cupo*, 394 N.J. Super. 357, 378 (App. Div. 2007), *rev'd on other grounds*, 196 N.J. 502 (2008).
16. *Casella v. Home Depot USA, Inc.*, No. CIV.A. 09-0421 (JAP), 2010 WL 3001919, at *3–4 (D.N.J. July 28, 2010) ("[A] former member of a limited liability company ... clearly does not fall within the plain meaning of the minority oppression statute which reserves the right solely for 'corporations with 25 or less shareholders.").
17. *Tutunikov v. Markov*, Docket No. A-1827-10T3 (App. Div. Aug. 1, 2013).