

Legal Options for Business Owners Who Don't Get Along

By David Reich, Esq.

What can I do if I no longer get along with the other owners of my company and am no longer satisfied with the manner in which it is being run? For better or worse, this has been a recurring question for individuals in privately held businesses. It is very common for business relationships which began among close friends or family members to go sour. This happens often when new members of the family become involved in the business or when the personal financial interests of owners begin to diverge. The purpose of this article is to provide the owner of a New Jersey corporation with a brief overview of his or her options under New Jersey law in the event this problem should arise.

Under the New Jersey statute, an owner is entitled to relief if his business is deadlocked or "in the case of a corporation having 25 or less shareholders, the directors or those in control have acted fraudulently or illegally, mismanaged the corporation, ... or ... acted oppressively or unfairly toward one or more minority shareholders..." A deadlock is established if shareholders are too divided in voting power to elect successor directors at two consecutive annual meetings or cannot act on "one or more substantial matters respecting the management of the corporation's affairs." In determining whether directors or those in control have acted oppressively, courts will often address whether a minority shareholder's reasonable expectations have been thwarted. These expectations can be non-monetary, as well as monetary. For example, in some instances, a court might consider

termination of a minority shareholder's children from employment to be oppressive. In affording relief from oppressive conduct, the courts have interpreted the term "minority" loosely and applied it even to situations where there is no true minority, but rather a 50/50 split among the shareholders.

If an owner or shareholder can show that he has met one of the criteria entitling him to relief from his business situation, the New Jersey statute then gives the court some specific options. The court may appoint a provisional director with the same powers as other directors or a custodian to manage the affairs of the corporation. In a more extreme case the statute authorizes the court to dissolve the company. Courts will usually try to avoid this remedy because they recognize that a

company's going concern value is generally worth more than its liquidated value. Courts are also reluctant to endorse a solution that will cause employees to lose their jobs.

The preferred solution where there are irreconcilable differences is typically a buyout of one side's ownership interest by the other. Assuming a right to relief has been established, the court has the power to order a buyout sale, if the court determines such a sale would be "fair and equitable to all parties under all the circumstances of the case."

After a buyout is ordered, the court is required to determine the "fair value" of the shares that will be sold after hearing presentations from both parties' experts. Typically, the experts will rely upon one or more commonly-accepted valuation methodologies. For example, an expert may use a market approach, which focuses on the market value of comparable companies. The use of an income approach, which emphasizes prior earnings history, is also common.

Regardless of what approaches are used, the potential for fluctuation in arriving at "fair value" is enormous. The numbers are generally large to begin with and there may be significant multiplier effects before the final valuation number is

determined. An expert can make assumptions which can make a difference of hundreds of thousands or even millions of dollars in his final conclusion. A change in

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a particular comparable company selected or the particular interest rate used can have a huge impact on the bottom line.

It is obvious from this that anyone involved in a buyout dispute should be very careful in the selection of a valuation expert. An expert with good analytical skills and the forensic skills required to make an effective

presentation is essential.

Human factors are also likely to have an impact, at least subliminally, on the trial judge's decision. Many times a trial judge will find the middle ground between the two experts' opinions. That, however, is not always the case. For example, in one recent case, the trial judge found the conduct by the party seeking to sell his 50% interest so offensive that the trial judge imposed punitive damages. The trial judge also accepted, in their entirety, the conclusions of the valuation expert for the other party. The result was a final buyout valuation number that was only about half of the approximately \$8 million number fixed by the expert for the party seeking to sell, who the trial judge perceived as the bad guy.

The moral of this story is clear. An effective legal presentation that can convince a judge that a party's position is "reasonable" or at least that it is no more "unreasonable" than the other party's is absolutely critical.

A business owner does not have to continue to work with other owners with whom he has differences. When a business situation has grown intolerable, it will often make sense to seek a legal remedy. One should always remember, however, to proceed with caution. There is a lot at stake.

