# Commercial Litigation Briefs



September 2013

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## UNINVOLVED MINORITY SHAREHOLDERS NOT OPPRESSED BASED ON PRIOR COURSE OF CONDUCT AND REASONABLE SHAREHOLDER EXPECTATIONS

In *Goret v. H. Schultz & Sons*, Inc., Docket No. A-4281-10T1, Supreme Court of New Jersey, Appellate Division, September 10, 2013, a group of minority shareholders [and third-generation owners] of a closely-held company H. Schultz & Sons, Inc. (the "Company"), sued their cousins and siblings who were officers and directors of the Company, alleging breach of fiduciary duty to the Company and violations of New Jersey's minority shareholder oppression statute, N.J.S.A. 14A:12-7(1)(c).

For many years, the Company distributed annual profits to all shareholders in proportion to their ownership interests. The minority shareholders were never involved in the operation of the Company and were never consulted about business decisions. The Company did not hold regular shareholders meetings. In 2004, after several years of declining profits, the minority shareholders met with the Company's president and demanded redemption of their stock or liquidation of the Company. The president rejected these requests and litigation ensued.

The trial court ruled that the minority shareholders had not proven that they were "oppressed" as defined in N.J.S.A. 14A:12-7. While a finding of illegality or fraud is not needed to establish oppression, the statute requires that minority shareholders must prove a "frustration" of their reasonable expectations.

Although less profitable than in the past, the Company was a viable going concern with a sound financial position and limited debt. The court ruled that the rejection of the buyout offer from the minority shareholders, which would have required outside financing, was a permissible exercise of business judgment that would not be disturbed. In addition, although the minority shareholders had a reasonable expectation that the Company would be profitable each year, there was no expectation that the officers would forgo reasonable compensation during less profitable periods.

A specific incident in which the Company's president rejected an offer to sell the Company's warehouse for an amount in excess of $7 million without consulting any other shareholders was determined to be a breach of fiduciary duty. The remedy for this breach was a requirement to provide the minority shareholders with information and notice regarding future Company acquisitions and major business decisions. Although the trial court ruled that this requirement would be in place until the Company started paying regular distributions again, the Appellate Court ruled that the disclosure obligation should be ongoing.

The trial court's ruling, and affirmation by the Appellate Court, confirms that claims under the New Jersey oppressed shareholders statute are fact sensitive. The critical analysis is the determination of the shareholders' reasonable expectations. Often, the most significant proof of such expectations is the parties' prior conduct.

## CLIENT LIST IS AN "ASSET" UNDER THE UNIFORM FRAUDULENT TRANSFER ACT

In *Del Mastro v. Grimado*, Docket No. A-1433-11T4, Superior Court of New Jersey, Appellate Division, September 5, 2013, the Appellate Division reversed a trial court's dismissal of an action seeking to set aside and void the transfer of a business interest under the provisions of New Jersey's Uniform Fraudulent Transfer Act ("UFTA"), N.J.S.A. 25:2-20, et seq. Del Mastro had previously obtained a $531,000 judgment against Grimado in connection with an action for intentional infliction of emotional distress and invasion of privacy from distribution of explicit photos of Del Mastro.

Grimado was the 100% owner of a subchapter S corporation, ICI. ICI was a broker for the purchase and resale of electric motors used in medical equipment. During the trial in the underlying action, ICI was valued at between $250,000 and $750,000. Grimado claimed to have closed ICI because he could not handle the stress of working for himself. Shortly thereafter Grimado joined PDA. PDA was a single shareholder corporation owned and operated by McKee. McKee had previously worked for a manufacturer of electric motors used in medical equipment. McKee and Grimado had worked together on many transactions with ICI. Del Mastro alleged that the assets of ICI had been fraudulently transferred to PDA in an attempt to thwart Del Mastro's collection efforts against Grimado.

The trial court, sitting without a jury, found that Del Mastro had not proven by clear and convincing evidence that Grimado had fraudulently transferred ICI's assets. While an appellate court generally will not disturb the factual filings of a trial judge, the appellate court determined that the trial judge's ruling was so unsupported or inconsistent with the relevant evidence at trial as to "offend the interests of justice."

The appellate court focused on inconsistencies between Grimado's and McKee's testimony on how they started to work together. In addition, the appellate court noted that although Grimado testified at trial that he had closed ICI four months before the trial of the underlying matter, he presented expert testimony on the valuation of ICI at the underlying trial. When asked why he did not disclose at the underlying trial that ICI had been closed, Grimado responded "no one asked." The appellate court also criticized Grimado's claim that he had "lost" all records regarding his closure of ICI because of a computer virus and concluded that such a "loss" may constitute spoliation of evidence. The appellate court ruled that a client list applicable to a service business like ICI constitutes an "asset" in accordance with the UFTA. When Grimado joined PDA and started calling on ICI's former clients, he was, in essence, transferring the client list to ICI.

Having rejected most of the trial court's factual and legal conclusions, the appellate court remanded he matter for a new trial with a different judge.