Turning The (board room) Tables:
Corporate Dissolution at Common Law

By Gary E. Bashian*

All, too, will bear in mind this sacred principle, that though the will of the majority is in all cases to prevail, that will to be rightful must be reasonable; that the minority possess their equal rights, which equal law must protect, and to violate would be oppression.

- *Thomas Jefferson*

Whether one's Trusts and Estates practice focuses on planning, administration, and/or litigation, advising a client on the creation, disposition, or distribution, of a closely held corporation is something that most Surrogate's Court practitioners will be confronted with at least one point in their careers.

Commonly, upon the passing of a shareholder in a family owned company, usually the last surviving parent, the shares in the family business which they accumulated during their life are distributed to their children in one manner or another. However, not all shares, or shareholders, are created equally.

Where some beneficiaries might suddenly find themselves majority stockholders of the family company, enjoying all of the benefits their majority ownership interests afford, other beneficiaries might not be so lucky, becoming minority shareholders, and left to wonder what benefits they can expect from their minority interest. Minority shareholders can find themselves the owner of stock in a profitable company, but receiving no return whatsoever in this interest, unable to sell their shares to an outside investor, and faced with only paltry offers from the majority stockholders/officers who shrewdly refuse to offer even book value for the stock knowing that the minority shareholder can sell to them and no one else.

These minority shareholders will often approach counsel with a multitude of questions about their newfound status, asking whether they will receive a dividend, obtain employment with the company, have a say in how the company is operated, can they sell their stock, and generally wondering what their ownership interest means for them in terms of dollars and cents. The answers to these questions will of course depend on the operational nature of the company itself, and how the majority treats the minority owners. That being said, minority shareholders are frequently "frozen out" by the majority, rendered powerless, and left with little recourse to be heard by either the company, or the Courts, as their stock ownership grants them few, or none, of the rights and benefits they

might expect. Ordinarily, minority shareholders are left with one of two options, accept the status quo, or seek dissolution of the company so they can redeem their liquidated interests.

Importantly though, New York Business Corporation Law 1104-A can only offer some minority shareholders statutory relief as it is restricted, allowing minority shareholders who own a 20% interest, or more, in the corporation to seek dissolution. Unfortunately, at least for Plaintiffs, more often than not this statutory requirement precludes them from bringing suit under the BCL.

However, in New York an action for corporate dissolution at Common Law still empowers a minority shareholder, regardless of their ownership interest in the company, to seek judicial dissolution on equitable grounds where it can be established that the majority has engaged in a "palpable breach of their fiduciary duties to the corporation" and/or "oppressive conduct" toward the minority.[1] While dissolution of a corporation on Common Law grounds is not frequently used, or reported, those Courts that have considered Common Law dissolution have made clear that their equitable authority force the breakup of a company is only warranted where the majority shareholder/officers are found to have breach of their fiduciary duties to the minority.

Without question or exception, one of the fundamental principles of corporate law is that the management owes an absolute fiduciary duty of loyalty to the corporation, and by extension the shareholders. This fiduciary obligation requires that they "treat all shareholders fairly and equally…preserve corporate assets, and…fulfill their responsibilities of corporate management with 'scrupulous good faith.'" [2] It is presumed that a minority shareholder expects some return on their ownership interest in a company. When the majority shareholder/officers wrongfully and intentionally deny them this return; engage in oppressive acts toward the minority shareholders; perpetuate the corporation's existence for their own benefit; loot the corporate assets; artificially depress the value of the company; and/or engage in gross mismanagement of the company, this duty is deemed breached.

Typically a closely held corporation is just that, an entity that is owned and operated by a close knit group, usually family members, who have a common interest and purpose for the company, and where the majority shareholders are also the corporate officers and board members. Almost invariably, this leads to a concentration of power and decision making in the hands of a very few, and often to the detriment of the minority interests.

Indeed, minority shareholders can be owners of a company in name alone as they frequently will have no voting rights; not be issued a dividend; have no opportunity to become an employee, manager, and/or officer; and are treated with little more than disdain by those in the majority. Meanwhile, the majority shareholder/officers of these

companies frequently take full advantage of the benefits of their position, i.e.: determining the terms of their own compensation; issuing themselves bonuses independent of corporate performance or profitability; granting themselves and immediate family extended healthcare benefits and perquisites; and using their powers to hire, fire, and hand select members of the board and employees loyal to them. Such actions can lead directly to the artificial devaluation of the company as a whole as the operational and investment capital available will be periodically depleted for the benefit of the majority, which in turn limits both financial and market growth, and causes direct harm to the corporation and those minority shareholders who receive no benefits whatsoever.

Although there is no established or bright line test to determine if Common Law dissolution is appropriate, the Courts have found that the following types of management practices can constitute a breach of fiduciary duty which will allow a Common Law dissolution suit to proceed:

- That the majority shareholders have carried on the company for the purpose of enriching themselves at the expense of the minority;

- That the majority has engaged in self-dealing and/or waste, including excessive compensation and perquisites, conversion and/or looting of corporate assets, and/or causing the loss of corporate opportunity;

- That the majority shareholders have attempted to force the majority to sell their shares to them for below their reasonable value, especially where there is an intentional deflation or impairment of the stock for this purpose; and/or

- That the majority have prevented the minority from engaging in business activities, effectively freezing them out.

Detailed and factual allegations outlining any, or all, of the majority actions listed above will allow Plaintiff to proceed with a Common Law dissolution suit, at least past the pleading stage, as they evidence the necessary “palpable breach” of corporate fiduciary duties. Indeed, should a client find themselves in the unfortunate position of a minority shareholder effectively locked out of the company in which they have an interest, dissolution at Common Law might be their only viable path to judicial relief.

While dissolution may seem an extreme form of recourse to protect minority interest, in reality, what other option is a minority shareholder left with in order to obtain a return their ownership interest? They cannot sell their interests on the open market for a reasonable return, they have no say in the manner in which the company can or will compensate them for their interest, and they are forced to silently watch as the majority continues to abuse their corporate powers at the minority’s expense. Short of forcing the break-up of

the company, liquidating its assets, and redeeming their stock based on the liquidated value of the company, minority stockholders really have no other options when left confronted with an unreasonable and unyielding majority.

Helping clients obtain the best results possible is rarely easy; often it involves finding solutions in unexpected areas of the law, especially where no straightforward statutory relief may exist. Exercising a minority shareholder client's right of corporate dissolution at Common Law is but one more example of this, and one which requires counsel to gather all the facts and evidence necessary in order to ensure that majority shareholders who trample on the rights and interests of the minority pay for the fair market value of those minority shares, or have their company equitably dissolved. The Courts are, after all, ultimately here to balance the rights and interests of the majority with those of the minority, and to protect and ensure that neither side shall oppress the other.

*Gary E. Bashian is a partner in the law firm of Bashian & Farber, LLP with offices in White Plains, New York and Greenwich Connecticut. Mr. Bashian is a past President of the Westchester County Bar Association, he is presently on the Executive Committee of the New York State Bar Association's Trust and Estates Law Section, is a past Chair of the Westchester County Bar Association's Trusts & Estates Section, past Chair of the Westchester County Bar Association's Tax Section, and a member of the New York State Bar association's Commercial and Federal Litigation Section.

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[1] The authoritative cases on corporate Dissolution at Common Law in New York include: Liebert v Clapp (13 NY2d 313); Matter of Kemp (64 AD2d 63); Kruger v Gerth (22 AD2d 916); Fontheim v Walker (282 AD 373); Lewis v Jones (107 AD2d 931).
[2] Matter of Kemp (*supra*.)