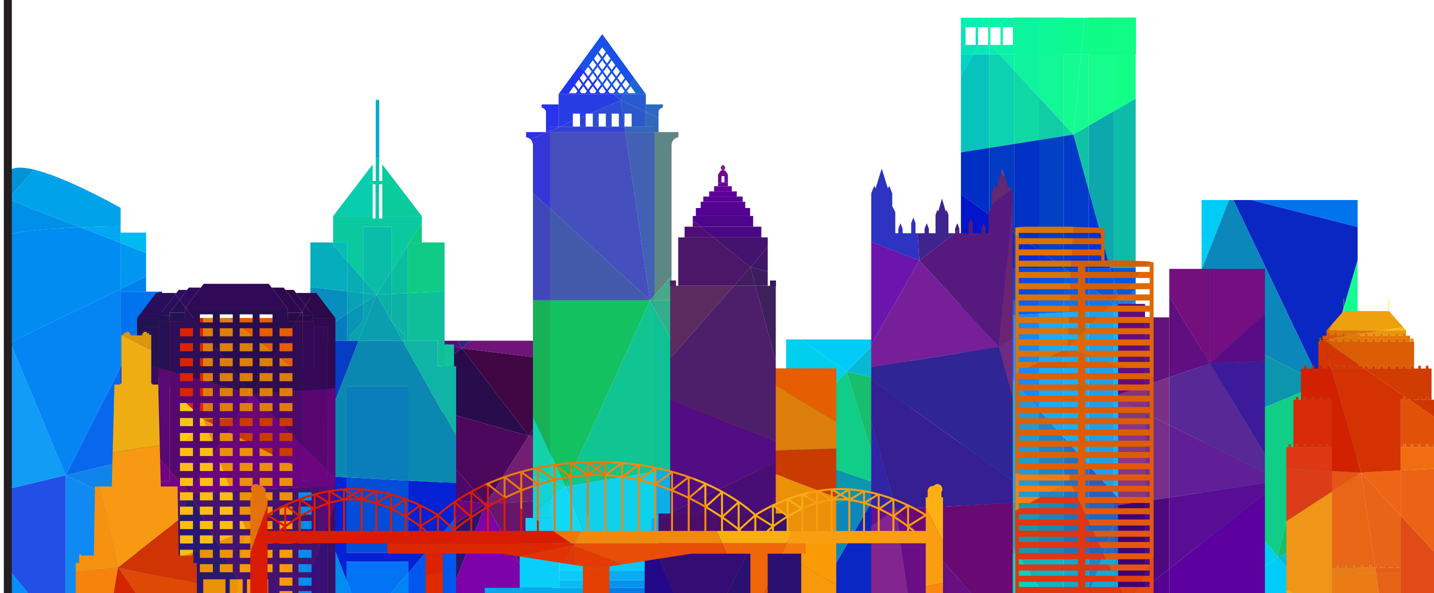
Economic & Legal Considerations in Shareholder/Equity Owner Oppression

presented by the GYF Business Valuation & Litigation Support Services Group

Grossman Yanak & Ford LLP
Certified Public Accountants and Consultants



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Grossman Yanak & Ford LLP

Headquartered in Pittsburgh, Grossman Yanak & Ford LLP is a regional certified public accounting and consulting firm that provides assurance and advisory, tax planning and compliance, business valuation, ERP solutions and consulting services. Led by six partners, the firm employs approximately 55 personnel who serve corporate and not-for-profit entities.

Our firm was founded in 1990 on the idea that the key to successful, proactive business assistance is a commitment to a high level of service. The partners at Grossman Yanak & Ford LLP believe that quality service is driven by considerable involvement of seasoned professionals on a continuing basis. Today's complex and dynamic business environment requires that each client receive the services of a skilled professional with a broad range of experience and knowledge who can be called upon to provide efficient, effective assistance.

Grossman Yanak & Ford LLP combines a diversity of technical skills with extensive "hands-on" experience to address varied and complex issues for clients on a daily basis. We pride ourselves on bringing value-added resolution to these issues in a progressive and innovative manner. Our ability to produce contemporary, creative solutions is rooted in a very basic and ageless business premise – quality service drives quality results. Our focus on the business basics of quality technical service, responsiveness and reasonable pricing has enabled the firm to develop a portfolio of corporate clients, as well as sophisticated individuals and nonprofit enterprises.

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Robert J. Grossman, CPA/ABV, ASA, CVA, CBA

Bob heads our firm's Tax and Business Valuation Groups. He has nearly 40 years of experience in tax and valuation matters that affect businesses, both public and private, as well as the stakeholders and owners of these businesses. The breadth of his involvement encompasses the development and implementation of innovative business and financial strategies designed to minimize taxation and maximize owner wealth. As his career has progressed, Bob has risen to a level of national prominence in the business valuation arena.

His expertise in business valuation is well known, and Bob is a frequent speaker, regionally and nationally, on tax and valuation matters. Bob is a course developer and national instructor for both the American Institute of Certified Public Accountants (AICPA) and the National Association of Certified Valuators and Analysts (NACVA). He has served as an adjunct professor for Duquesne University and Saint Vincent College. He has also written articles for several area business publications and professional trade journals.

After graduating from Saint Vincent College in 1979 with Highest Honors in Accounting, Bob earned a Masters of Science degree in Taxation with Honors from Robert Morris University. He is a CPA in Pennsylvania and Ohio and is accredited in Business Valuation by the AICPA. Bob also carries the well-recognized credentials of Accredited Senior Appraiser, Certified Valuation Analyst and Certified Business Appraiser.

A member of the American and Pennsylvania Institutes of Certified Public Accountants (PICPA), Bob has previously chaired the PICPA Pittsburgh Committee on Taxation. He has also served as Chair of the Executive Advisory Board of NACVA, its highest Board; as well as Chair of NACVA's Professional Standards Committee and its Education Board.

Bob received NACVA's "Thomas R. Porter Lifetime Achievement Award" for 2013. The award is presented annually to one of the organization's 6,500 members, who has demonstrated exemplary character, leadership and professional achievements to NACVA and the business valuation profession, over an extended period.

Bob is a member of the Allegheny Tax Society, the Estate Planning Council of Pittsburgh and the American Society of Appraisers. He has held numerous offices in various not-for-profit organizations. Bob received the PICPA Distinguished Public Service Award and a Distinguished Alumnus Award from Saint Vincent College.

Bob and his wife, Susie, live in Westmoreland County. They have two grown children.

Melissa A. Bizyak, CPA/ABV/CFF, CVA

Melissa, a partner in the firm's Business Valuation & Litigation Support Services Group, has practiced in public accounting for more than 21 years. She has significant experience in business valuation and tax-related issues for privately-held concerns and their owners.

Her business valuation experience is diverse, including valuations of companies in the manufacturing, oil and gas and technology industries. These valuations have been performed for various purposes such as financial reporting, equitable distributions, buy/sell transactions, dissenting shareholder disputes, Employee Stock Ownership Plans (ESOPs), value enhancement and gift and estate tax purposes. Melissa also provides litigation support services including expert witness testimony.

After graduating from the University of Pittsburgh in 1994 with a B.S. in Business/Accounting, Melissa spent two years with a local accounting firm in Pittsburgh. She joined Grossman Yanak & Ford LLP in 1997.

Melissa is a certified public accountant and is accredited in business valuation and certified in financial forensics by the American Institute of Certified Public Accountants (AICPA). She has also earned the AICPA Certificate of Achievement in business valuation. Additionally, Melissa carries the credentials of Certified Valuation Analyst.

Her professional affiliations include the AICPA, the Pennsylvania Institute of Certified Public Accountants (PICPA) and the Estate Planning Council of Pittsburgh. She is a member and previously served as the Chair of the Executive Advisory Board of the National Association of Certified Valuators and Analysts (NACVA). Melissa has written business valuation course-related materials and serves as a national instructor for NACVA. She has also authored articles appearing in professional publications.

Melissa is a graduate of Leadership Pittsburgh, Inc.'s Leadership Development Initiative. She serves on the Board of Directors of the Children's Museum of Pittsburgh and is a member of the Executive Leadership Team for the American Heart Association's "Go Red for Women" initiative. Melissa is also a mentor for women business owners through Chatham University's MyBoard program. She was one of four female CPAs in the State of Pennsylvania to be honored in the PICPA's "Women to Watch" awards in 2017.

Melissa resides in the South Hills of Pittsburgh with her husband and their two sons.

Brad W. Matthews, CPA/ABV, CVA

Brad has focused his career on providing valuation and litigation support services since joining Grossman Yanak & Ford LLP in 2011. His experience includes financial statement and historical financial trend analysis, financial modeling, and business risk assessment, as well as performing calculations required for the preparation of business valuations and other consulting projects.

Brad has served clients in many industries including manufacturing, professional services, financial services, engineering, construction, retail, management consulting, oil and gas, and technology. He has played a significant role in providing business valuation services for a range of purposes including gift and estate tax planning, Employee Stock Ownership Plans (ESOPs), marital dissolutions, corporate divorce/shareholder disputes, financial and tax reporting, buy/sell transactions, and general business planning. Further, his litigation support experience includes the determination of lost profits and economic damages arising from various disputes.

Brad graduated from the University of Pittsburgh, earning a double major in Accounting and Finance with a minor in Economics. Brad is a graduate of Class XXIV of Leadership Pittsburgh Inc.'s Leadership Development Initiative (LDI) program that hones the leadership skills of high-potential young professionals.

He is a certified public accountant (CPA) and has earned the Certified Valuation Analyst (CVA) designation conferred by the National Association of Certified Valuators and Analysts (NACVA).

In his spare time, Brad enjoys golfing, following Pittsburgh sports and spending time outside with his family. He lives in the North Hills with his wife, Alexis.

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I. Introduction

> *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
> *First Inaugural Address, 4 March 1801*

Few concepts in business law conjure up images of misdeeds and overbearing behavior more than the term, "shareholder[1] oppression." Arising from a number of broad actions related to the exercise of control by those equity owners holding a majority of any enterprise's voting equity interests, the common denominator in all cases of equity owner oppression is an ownership structure comprised of a majority owner(s) and a minority owner(s).

The concept of shareholder oppression presupposes a position of equity capital ownership in a business enterprise that constitutes both legal and factual control to mandate enterprise-level decisions over a position of equity capital ownership that legally and factually lacks such control to mandate or reverse such decisions.

To be sure, exercise of control over a non-controlling, minority equity capital position is not, in and of itself, a legal or operational problem. Such capital structures have been (and are) integral to the creation and operation of many successful businesses in the United States and are very often the effective result of matching monetary capital funding with management groups and those with creative business ideas.

However, the legal matter that sits at the center of any shareholder oppression matter is the majority or controlling shareholder's(s') or shareholder group's(s') misuse of that control in taking actions that allegedly prejudice those shareholders lacking the attribute of control in their ownership.

The issue of shareholder oppression arises in the context of privately-held businesses. Certainly, a non-controlling or minority owner of an equity interest in a publicly-traded enterprise can feel as if decisions are being made that are unfair to him/her, or that management of that enterprise has engaged in "bad acts" harmful to the company and the non-controlling or minority owner. However, in these instances, the investment attribute of "marketability" generally serves to indirectly protect the equity owners from the repercussions of these actions.

1 The terms, "shareholder" and "equity owner" are used interchangeably in these materials and are intended to apply equally to a partner, member and any other equity owner interest in a business entity.

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All equity "value" is predicated upon the determination of expected future economic benefits associated with the ownership of a particular equity interest. Those expected future economic benefits are then "discounted" back to present value to the date of valuation at a risk rate that is commensurate with the investment risks associated with the subject equity interest holding.

The great investment risk facing a holder of an equity interest in a privately-held enterprise, which is not present in a publicly-traded enterprise, is the lack of a ready market on which the equity interest can be easily, and quickly, liquidated and exchanged for cash. The existence of such a ready and common trading market for publicly-traded shares is highly regarded in the finance and investment community, and the lack of such a trading market in the privately-held business arena is deemed to present a substantial investment risk, which ultimately works to significantly reduce the value of minority equity interests in those enterprises.

Instances of alleged shareholder oppression clearly, and directly, illustrate the abject risk associated with a lack of a ready trading market. In those cases where management allegedly does undertake actions that the minority shareholder believes are unfair and harmful to his or her particular equity ownership position, the lack of a ready trading market forces that equity owner to hold onto the investment position and "ride out" the storm. In such cases, the minority equity owner is generally forced to maintain the status quo unless the level of alleged harmful actions rises to the point where legal protections under the organizing state's shareholder protection statutes are invoked.

Further exacerbating the position of the minority equity owner's investment position in any privately-held business enterprise are the often-present shareholder, partnership and limited liability company agreements restricting the sale or transferability of the subject equity interests in that enterprise. Such provisions, including formula-based valuation determinations, can often work to depress value as they inject even further investment risk by narrowing the already-limited market for the minority equity interests.

That is not to say that such agreements are not useful. In fact, in such a context of equity owner discord, properly drafted agreements can address a number of meaningful objectives, including setting protocols for management and controlling equity owner decisions, which can later serve to minimize the risk of minority ownership oppression challenges.

Basic economic elements of investment theory dictate that a minority equity owner position represents an investment for which he/she entered negotiation and for which he/she "bargained" the purchase price. The underpinnings of this concept center on the reasonable idea that any potential investor could – and should – have predicated the cost of that subject equity interest on expected future economic benefits and the risks associated with the future receipt of those benefits. Chief among the risk assessment, and in performing due diligence, is the risk that the majority equity owners would use their control positions as a means of affording themselves unfair economic opportunities and advantages.

Though many, if not most, privately-held companies have a limited number of equity owners, thereby making such negotiations and due diligence a reasonable expectation, the courts still offer a means to remedy minority equity owner oppression. Most often, the largess of the courts in these matters appears to be founded on the premise that controlling majority equity owners have a fiduciary responsibility to the minority, and that meeting that fiduciary responsibility requires conduct of the business in a manner that meets the "reasonable expectations" of the minority ownership.

While the economic elements seem to be in direct conflict with the statutory and judicial protections for minority equity owners offered by the statutes and courts, the authors believe that the latter are necessary to overcome the limitations imposed in the negotiation process. Though monetary leverage is sometimes available to the minority equity owner group as a means to "bargain" for their ownership interest, our experience would indicate that it is a rare circumstance that provides adequate negotiation at early stage capital raises to allow for a complete and proper due diligence process. Moreover, many privately-held companies are organized by related parties (often families) and others known to the organizers. In these cases, it is not uncommon that the element of trust comes into play. Without this trust, many startups would never survive the formation process. Finally, even if an incoming minority interest owner has the time and money to conduct proper due diligence and works towards clarity and propriety in assessing risk, there is only so much that can be done to quantify this risk prior to making the investment.

As a result of these limitations, the need for equity owner protections and shareholder oppression remedies is real. Such protections offer the minority equity owners a means of reasonable investment protection.

There are any number of majority equity owner actions that may be alleged in such matters as having been harmful to the minority equity owner group. While not an all-inclusive list, the following offers the more commonly-noted actions, or lack thereof, that often crop up in shareholder oppression cases:

- A failure by the company to declare or pay dividends or make distributions to minority equity owner;
- A failure to pay "agreed-upon" compensation or other monetary remuneration to minority shareholder;
- Withholding critical operating, financial or business information from minority equity owner;
- Dismissal of minority equity owner as an employee;
- Dismissal of minority equity owner as a member of the board of directors;

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- A failure to notify minority shareholders of meetings that they are entitled to attend;
- Taking actions that allow for unjust enrichment of the majority owners;
- Attempting to push the minority equity owner out of the company.

These actions will be discussed further in Chapter II in these materials. Certainly, shareholder oppression can take many more forms than the few examples set forth above. One need only think about the unjust enrichment of a majority ownership group at the expense of the minority ownership group to facilitate a discussion about a broad range of potential actions that might be utilized as alleged causes of an oppression matter.

Aiding members of the legal community in determining the economic effect of alleged majority equity owner oppression against a minority equity owner is at the heart of the role played by Grossman Yanak & Ford LLP in such matters. Our services extend to both plaintiffs and defendants. To understand how this role is fulfilled, it is first necessary to briefly discuss the various remedies available in such actions.

Generally, the remedies in an oppression proceeding are most often reduced to an economic platform comprised of a monetary resolution. These remedies often include the determination of monetary damages resulting from actions taken by the majority equity owners that ultimately serve to misuse corporate assets and/or unjustly enrich majority equity owners. Though it is the experience of the authors that many of these determinations involve a specific matter calculation, such as addressing excess economic enrichment actions including excess compensation, rent or other corporate expense; sometimes, the actions can only be measured in terms of shareholder/equity owner value before and after the alleged majority equity owner oppressive actions.

Valuations in this context are generally intended to assist counsel and their client(s) in assessing the estimated economic impact of the alleged action. To make this determination, depending on the controlling state law statutes, the general goal in remedying such matters is to ensure that the plaintiff minority equity owner is returned to the same financial position he/she was at prior to the alleged oppressive action(s) by the majority equity owners.

Members of the business valuation community are usually required in such circumstances to adopt a "fair value" standard of value. For these purposes, fair value is generally defined by statute in each respective jurisdiction, and must be respected. The standard of value in Pennsylvania shareholder actions is fair value, which is defined as:[2]

> *"The fair value of shares immediately before the effectuation of the corporate action to which the dissenter objects, taking into account all relevant factors, but excluding any appreciation or depreciation in anticipation of the corporate action."*

[2] 15 Pa. C.S. § 1571-1579

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While the term, "fair value" will be discussed in greater detail later in these materials, note that the definition of value required under the laws of the Commonwealth aligns very closely with the overall goal of seeking equitable economic resolution in oppressed equity owner actions.

The breadth of challenges through the courts relating to shareholder/equity owner oppression is staggering. The intent of the authors today is to simply review the important elements surrounding such cases and to offer a general view of the positions of the courts in addressing the many variations in factual circumstances.

The materials are not intended to be an all-inclusive listing of cases in Pennsylvania or any other jurisdiction. Nor is it the intent of the authors to offer any legal opinions of any kind. The program is designed to simply familiarize those attending with certain fundamental concepts we have observed in working with members of the legal community on a variety of cases.

As is the case with each of our programs, the material is segregated into multiple chapters to allow for a separation of issues related to these types of legal actions. The information to be shared today is as follows:

- **Chapter II – *Shareholder/Equity Owner Oppression – Causes of Action***
- **Chapter III – *General Concepts and Role of Experts***
- **Chapter IV – *Case Law Examples***
- **Chapter V – *Valuation in Oppression Actions***
- **Chapter VI – *Conclusion and Practical Considerations***

We appreciate the opportunity to have worked with many of you in the past, and we thank you for your continued support in affording us an opportunity to provide expert economic, financial and valuation services as you represent your clients. We look forward to continuing to work with you.

We realize that each of you has an exceedingly busy schedule, and that taking time from your practice is always a challenge. We especially thank you for attending today and hope that the information conveyed will allow you to return to your office and practice with just a little more information than you might have had before!

Please feel free to contact any of the speakers if you have questions that we do not address. Thank you!

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II. Shareholder/Equity Owner Oppression – Causes of Action

The crucial element of majority shareholder responsibility to a minority shareholder is fiduciary. In most states, including the Commonwealth of Pennsylvania, this concept is generally held to mean that those controlling shareholders owe a duty to the minority shareholders to conduct the activities of the corporation in a way that ensures that the *reasonable expectations* of the minority shareholders in making the decision to invest in the enterprise are met.[3]

Oppressive actions by the majority shareholders, then, are those actions and "conduct that substantially defeats the reasonable expectations held by the minority shareholders in committing their capital to the particular enterprise."[4] Said another way, "the majority have a duty not to use their power in a way [so as] to exclude minority shareholders from their proper share of benefits accruing from the enterprise."[5]

As will be discussed briefly in Chapter III, there are certain protections afforded to majority shareholders in the course of their operational and financial decision making under the business judgement rule. However, the protections available under this rule do not generally extend to those decisions found to be adverse to the reasonable expectation of the minority shareholders.

What then, are those specific actions which commonly give rise to a claim of shareholder or equity owner oppression? Though a number of the most common actions are listed in the Introduction chapter, a brief discussion of each is relevant here as a means of understanding the manner in which each action defeats the reasonable expectations of the minority shareholder, thereby compromising majority shareholder fiduciary duty.

A failure by the company to declare or pay dividends or make distributions to minority equity owners

A commitment of capital to any business enterprise is based, logically, on the future expectation of a return on investment commensurate with the risk attendant to that investment. Given the ownership attributes of a minority interest in any privately-held business enterprise, such investments are fraught with risk. In addition to having no control over management decisions that might have a bearing on future economic performance, the equity interest very often lacks a ready market for disposition. As such, any investor in such an equity interest would expect, and, in fact, require, some level of dividends and/or cash flow distributions.

[3] *Bair v. Purcell*, 500 FSupp 2d 468, 483 (MD Pa 2007)

[4] *Ford v. Ford,* 878 A 2d 894 (Pa Super Ct, 2005)

[5] *Viener v. Jacobs*, 834 A 2d 546,556 (Pa Super Ct, 2003)

The failure to make such distributions and the relationship to an alleged oppression transaction must logically be based on the enterprise's "dividend-paying capacity." Though primarily an income tax concept, dividend-paying capacity simply refers to the capability of the business entity to make such dividend payments or distributions without harming the entity's ability to continue to accomplish its overall business objectives in the future.

That is not to suggest that a failure to pay dividends or make distributions can be viewed in a vacuum if specific business needs unrelated to alleged majority actions rising to the level of oppression requires retention of earnings. Further, a failure to pay dividends or make distributions must always be assessed in conjunction with other "majority equity owner directed payments and perquisites." In the discipline of business valuation, a failure to receive dividends or distributions, in combination with a lack of control and a lack of marketability, equates to a severe negative impact on value.

A failure to pay "agreed-upon" compensation or other monetary remuneration

This matter is often raised in equity owner oppression cases. The lack of economic payment for services, personal or otherwise, (especially under an agreement or contract setting forth terms for the payments) can often represent a breach of duty under those agreements.

In many cases, the determination of the economic effect of a failure to pay "agreed-upon" compensation or other monetary remuneration by the majority shareholders is easily determinable, provided that details of the arrangements are set forth in the agreements or contracts. On the other hand, in those cases where insufficient detail is memorialized in the guiding documents, facts and circumstances will dictate the determination of any unpaid amounts that are alleged to have been the subject of a majority equity owner oppressive action.

Facts and circumstances vary widely from case to case. Majority equity owner counter-arguments to unpaid amounts due to minority shareholder often turn on suggestions of a lack of performance, or a failure to provide the subject "agreed-upon" services.

Withholding critical operating, financial or business information

Under Pennsylvania law, shareholders of privately-held corporations have certain inspection rights relating to corporate records and accounting.[6] Upon proper written demand, the statute provides that shareholders of a corporation have the right to examine and copy the share register, books and records of account, and the records of proceedings of the incorporators, directors and shareholders, so long as the purpose for their request is relevant and germane to their position as a shareholder. Similar rights are accorded to holders of minority interests in partnerships and limited liability companies.

[6] 15 Pa. C.S. §1508

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Review of company financial records is always germane to a minority equity owner's investment management. Without access to the information, a minority equity owner has no means by which to evaluate his/her return on investment. It is not necessary that the purpose for the shareholder demand be an allegation of fraud, mismanagement or oppression. Simple demands for information with the purpose of reviewing corporate oversight or evaluating overall corporate activity and performance are generally sufficient.

The failure to provide critical operating, financial or business information can frustrate the minority equity owners' efforts to manage their investment risk, possibly leading to economic losses attributable to unidentified business risks. In addition, withholding such information can lead to situations where majority equity owners operate in a closed environment without any outside oversight, review, and or challenge.

Dismissal as an employee

Dismissal of a minority owner from a position of employment often accompanies other elements of alleged majority actions leading to a legal proceeding alleging oppression. Most often, the authors have observed employment dismissal by majority shareholder groups to be a means of separating the individual holding the minority equity owner interest from day-to-day operational activities. Accompanying this separation from employment is the obvious disassociation with the daily operational activities and financial information.

In many cases, the minority equity owner holds a management position, which, by definition, would constitute a higher paying job and generally allow for greater access to corporate records and corporate benefits. A termination that is found to be unjustified in an alleged oppression matter will likely lead to claims for lost income and financial benefits associated with the position.

Dismissal as a member of the board of directors

Like the previous action, where there is a dismissal of a minority equity owner as an employee, dismissal from the board of directors can be a cause of action for an oppression proceeding. In these instances, access to board decisions, and the operational and financial input into those decisions, is at the heart of the alleged oppressive behavior.

Moreover, as the board has the ultimate oversight for the appointment of corporate officers and compensation related to their responsibilities, elimination from the board of directors also removes the minority equity owner from those considerations. The lack of knowledge relating to such matters, as well as other avenues of diverting corporate economic benefits to the majority equity owner(s), leaves the minority equity owner at a disadvantage in evaluating the propriety of management decisions.

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Finally, as a result of such a dismissal, the terminated Director is not able to reap the economic rewards of holding the position. This often includes compensation and associated perquisites of sitting on the enterprise's board of directors.

A failure to notify minority shareholders of meetings that they are entitled to attend

Owners of Pennsylvania corporations are generally required to hold an annual meeting at which the shareholders of the corporation will elect its board of directors. Alternatively, the board of directors election can be undertaken by unanimous written consent. The time and manner for the annual meeting is generally set out in the corporation's by-laws.[7]

Shareholders meetings may also be held by means of the telephone or other means of technology, provided the shareholders have the opportunity to:

- Read or hear the proceedings substantially concurrent with their occurrence
- Vote on matters submitted to the shareholders
- Pose questions to the directors
- Make appropriate motions
- Comment on the business of the meeting[8]

In addition, corporations must notify shareholders of the date, time and place of the meeting

- 10 days prior to a meeting that will consider a transaction, such as a merger, or a fundamental change, and
- 5 days prior to a meeting called for any other purpose.[9]

Finally, Pennsylvania rules provide that the presence of a sufficient number of shareholders entitled to vote must attend, and that of these attending shareholders, a majority vote is required to constitute a quorum for purposes of consideration and action on any particular matter.[10]

[7] 15 Pa. C.S. §1755(a)
[8] 15 Pa. C.S. §1704
[9] 15 Pa. C.S. §7702 and §1704
[10] 15 Pa. C.S. §1756

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It is the majority shareholders' ability to obtain a shareholder-approved action that leads to the problem of oppression from the minority shareholder's perspective. While that shareholder, alone, cannot force a decision on any action, his or her presence at such meetings allow for input and debate, thereby, enhancing corporate governance by inviting opposing positions and opinions. The failure to invite the minority shareholders/equity owners to such meetings defeats this purpose. As a result, such actions (or lack of action) as a "failure to notify" are among the most common reasons for majority equity owner oppression cases.

Measurement of the economic detriment suffered by the alleged oppressive action of a failure to notify by the majority shareholders is predicated upon the actions undertaken at the meetings and the economic outcomes of those actions. Oftentimes, the effect of the missed meetings are not separately quantified but, rather, used as a means of establishing the overall oppressive nature of the majority. The quantification process, then, extends to the actions actually undertaken, and which are alleged to have defeated the reasonable expectations of the minority shareholder(s).

Taking actions that allow for unjust enrichment of the majority owners

Perhaps the most common of all actions deemed to be oppressive is the diversion of the economic benefits of corporate or business entity ownership to the majority owners. Such diversions work to move a disproportionate level of these benefits to those equity owners controlling the organization.

Examples of such transactions are expansive. While the most common example might be excess compensation paid to the majority owner(s), there are a variety of means in which corporate-level funds might be inappropriately funneled to those individuals. Oftentimes, especially in family businesses, majority owners may deem it appropriate to employ family members and friends. To be sure, there are often related parties in such entities performing required duties for fair compensation. It is not uncommon, however, that majority owner family members are reaping disproportionate compensation for little or no work, or sub-par performance.

In consideration of the economic effect of such actions, it is necessary to consider all related perquisites, including healthcare, retirement plan contributions, club expenses, company cars, etc. In addition, paying for personal travel, dining and entertainment by the majority owner(s) presents another means by which they can reap disproportionate economic rewards.

Another avenue of diverting economic benefits to the majority owner(s) is through the over-charging for services from a related entity. Very often, the authors have observed majority owners holding real property used by the operating company in a separate business organization. A common way to defeat the minority equity owner position in the operating company is to charge rent at higher levels than the market would bear otherwise.

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Establishing the economic effect of these diversion strategies requires assessments of market-based fair value compensation and rent. Third-party databases can establish meaningful estimates of compensation by position, experience and responsibilities. Rent assessments can be made by comparisons to local market information.

Another form of unjust enrichment is through the misappropriation of corporate funds by majority shareholder(s) to purchase corporate-owned assets that provide little use to the corporation and more to the majority shareholder(s). Examples of such misappropriations might include sports cars, airplanes and boats. Yet another form of misappropriation can occur by diverting corporate opportunities to the benefit of the majority owner(s), versus bringing those opportunities to the corporation, and the entire equity owner group.

Attempting to push the minority equity owner out of the company

Transactions by the majority owner(s), undertaken for purposes of removing a minority equity owner from the ownership group, are most commonly referred to as "freeze out" or "squeeze out" transactions. Such transactions allow the majority owners to obtain ownership of the remaining equity ownership interests in that enterprise.

While there are numerous means by which to undertake a minority equity owner freeze out, perhaps the most common is one where the majority owner(s) create a second entity, which they control and which initiates a merger with the original corporation. The majority owners are then in a position to dictate the plan of merger. The end game is to force the minority stockholders in the original entity to accept a cash payment for their shares, effectively freezing them out of the resulting company, post-merger.

The outgrowth of this strategy is to reserve the upside future economic returns for the majority owner(s), as the minority equity owner will have been cashed out at fair value. Very often, such minority equity owner cash outs are attempted at a value that is less than fair value. In such instances, depending on jurisdiction, the state may grant minority equity owner relief, allowing for the exercise of a dissenting equity owner claim and the right to seek an independent appraisal of the shares held in that enterprise.

Beyond the exercise of his or her dissenting equity owner rights, such transactions often become the center of an oppression matter. Again, transactions designed to defeat the minority equity owner's "reasonable expectations" will be found to be actionable under this legal concept.

Determination of the economic effects of freeze out transactions center, specifically, on valuation. While this issue will be addressed in detail later in these materials, generally, the courts are looking for "overall fairness" in such transactions. Determination of overall fairness requires evidentiary hearings and, almost always, expert testimony.

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Most often, majority shareholders will arguably ***not*** be entitled to the deferential protection of the business-judgment rule to the extent their decisions focus on the internal rights of shareholders relative to each other, as in *Viener*.[11] In these instances, the burden of proof typically shifts to the majority to establish the "entire fairness" of such decisions – that is, "their utmost good faith and the most scrupulous inherent fairness of the bargain," as in *Weinberger*[12]and *Glosser*.[13]

As the *Viener* court explained, this "does not mean that majority shareholders may never act in their own interest, but when they do act in their own interest, it must also be in the best interest of *all shareholders and the corporation*." The business judgment rule will be addressed further in Chapter III.

The effort to determine fair value is a complex one, beginning with a jurisdictional understanding of the required standard of value, as well as application of that standard in that jurisdiction. It is the role of legal counsel in these matters to frame the arguments for any equity owner oppression matter, whether they represent the majority or minority equity owner(s).

The role that Grossman Yanak & Ford LLP has historically undertaken in such matters generally focuses on forensic matters, including a detailed review of history and a determination of the economic effects of certain actions alleged to be oppressive, a well as providing a valuation. Across the spectrum of these services, we work closely with legal counsel to provide independent and objective opinions of the economic impact of these actions.

[11] *Viener v. Jacobs*, 834 A 2d 546,556 (Pa. Super. Ct., 2003)

[12] *Weinberger v. UOP*, 457 A.2d 701, 710 (Del. 1983)

[13] *In re Glosser Bros.*, 555 A.2d 129, 134 (Pa. Super. Ct. 1989)

III. General Concepts and Role of Experts

The starting point for understanding the challenges of shareholder oppression is entity capital structure. It goes without saying that any "control" dynamic in such actions requires an ability to exert control over entity-level decisions that affect the economics of the ongoing enterprise and its ownership. As such, capital structure must first be assessed in discerning the viability of an oppression case.

Ownership and Degree of Control

It is a simple presumption that control rests in states embracing simple-majority rules that equity ownership in excess of 50% conveys control. In the simplest of capital structures among multiple owners, where one equity owner holds a 51% interest, while the other holds a 49% interest, the ability to potentially oppress the non-controlling minority owner is clearly present.

Similar thinking can be extrapolated to those states embracing supermajority voting status to accomplish certain corporate or entity-level actions. If a controlling equity owner having the required supermajority ownership advocates and undertakes a corporate-level transaction that benefits the decision maker to the detriment of the collective ownership group, non-controlling equity owner oppression can occur. In cases where the non-controlling equity owners object, or dissent, as in a takeover or merger transaction, they may express their disagreement with the actions of the controlling equity owners by exercising their available intrinsic rights, the most notable being a right to have their equity ownership interest appraised and then purchased at *fair value*.

Beyond the simple structures outlined above, an innumerable array of varying levels of ownership interests, and investment attributes attached thereto, can carry control or lessen the impact of a controlling shareholder group's impact on the corporate decision-making. This nuance alters the remedies available in any state in a shareholder oppression action.

Assume, for example, the varying levels of control manifested in alternative percentages of equity ownership. If one were to look at the illustration on the following page, he or she would note a number of ownership levels with differing attributes of control that, in combination with other equity ownership interests, could raise the inherent level of control in those ownership interests.

In every instance, the degree of ownership dispersion and the degree to which the controlling shareholder has the potential to divert economic income or perquisites from the minority shareholder(s) to the controlling shareholder are critical considerations.

100% ownership

Less than 100%, more than that required for majority

Less than supermajority control, more than 50%

50% ownership

Less than 50%, largest ownership block of stock

Less than 50%, in a swing vote position

Less than 50%, not a swing vote position

These ownership and control considerations may seem obvious, but factual differences in cases observed by the authors and decided by courts across the country illustrate the implications of establishing share ownership.

A classic example of a broader judicial interpretation of the word, "minority" does not necessarily require ownership of less than 50% of the outstanding equity in an organization. In a Pennsylvania decision, *Baron v. Pritzler,*[14] the Court found that under certain circumstances, a 50% shareholder could be oppressed by a more dominant shareholder who also holds just a 50% shareholder interest. In this case, the Court looked to Delaware and Oregon law in finding that, "equal owners of a close corporation are each entitled to the other's performance of fiduciary duties of loyalty, good faith, and full disclosures." Id. [Citing, *Delaney v. Georgia-Pacific Corp.*, 564 P.2d 277, 281 (Or. 1977); *Gilbert v. El Paso Co.*, 490 A.2d 1050, 1055 (Del. Ch. 1984).]

As a result of this decision, it is evident that controlling shareholders in Pennsylvania not only owe a fiduciary duty to the corporation itself, but also to the non-controlling shareholders. Interestingly, this case focused on the intangible elements of control and did not center its analysis specifically on the numerical level of stock held by each shareholder. Note that similar findings in cases involving a 50% shareholder being oppressed will be discussed in more detail in Chapter IV.

[14] *Baron v. Pritzler*, 2001 Pa. Dist. & Cnty. Dec. LEXUS 447 (Pa. 2001)

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Business Judgment Rule

From the perspective of the majority equity owners, certain actions, if undertaken in good faith, may be protected by the business judgement rule. This rule limits courts in second-guessing corporate decisions. Like any such protection, it must be designed to protect others from abuse of the discretion it provides.

Pennsylvania's corporate laws (the Business Corporation Law of 1988, or BCL) are codified in Title 15 of the Statutes of Pennsylvania. These laws contain specific rules governing the conduct, rights and duties of officers, directors and shareholders. Similar to other American jurisdictions, Pennsylvania's BCL on corporate directorial duties focuses on two major, foundational responsibilities owed to shareholders – *"A Duty of Care"* and *"A Duty of Loyalty."*

To meet the *Duty of Care*, corporate directors must undertake their duties *in good faith and with the degree of care that an ordinarily prudent person would use under similar circumstances*. The Commonwealth reviews the actions of the directors under the business judgement rule, recognizing that decisions by these individuals must sometimes be made with certain business risks associated with the attempt to get the greatest economic returns for the corporation and its shareholders. The business judgement rule was developed under case law, and generally provides that the courts will not interfere with the decisions and actions of the directors in managing the corporation if those decisions are made in good faith and on an informed basis.

To meet the *Duty of Loyalty*, directors must act *in good faith and for the benefit of the corporation and its shareholders.* Decisions made by the directors, and transactions related thereto, that involve a conflict of interest between the corporation and its shareholders and the directors are not protected by the business judgement rule. Examples of such actions might include self-dealing with the corporation, usurping corporate opportunities, and creating a competing venture.

The Pennsylvania Supreme Court, in *Cuker v. Mikalauskas,*[15] indicated that a corporate officer will not be liable for the consequences of his or her decision if all of the following criteria apply:

- The corporate officer had no personal interest in the outcome of the decision
- He or she was reasonably informed about the decision
- He or she rationally believed the decision was in the best interests of the corporation
- It was a business decision
- The decision was made in good faith

[15] *Cuker v. Mikalauskas,* 692 A.2d 1042, 1045 (Pa. 1997)

As always, the devil is in the details. It is clear that such an interpretation serves to limit the protections afforded by the business judgement rule, and that facts and circumstances will ultimately dictate the degree of protection afforded by the rule.

In defending against a shareholder oppression challenge, prudent majority equity owners should take all necessary steps to document and memorialize the thought process behind enterprise-level decisions of a material nature. While the rule, itself (if facts support), may serve to defeat a minority equity owner oppression action and save the majority equity owners from liability, it will likely not serve as a deterrent to those minority owners bringing the action. As such, appropriate record keeping is a must.

Determination of Ownership

There may be instances where the question of equity ownership is at the very heart of an equity owner oppression matter. A failure by the plaintiff minority equity owner to establish that he or she is, indeed, an equity owner under applicable state law voids any obligation on the part of the defendant equity owner(s) and enterprise.

On the other hand, the authors have observed cases where the plaintiff minority equity owner was able to successfully prove his or her ownership. In instances such as these, the plaintiff is a step closer to resolving the oppression matter in his favor, as such a line of defense implicitly suggests that the defendants failed to recognize the legal status of the plaintiff's equity ownership position. Because of this risk, it is imperative that attacks on the validity and presence of equity ownership be taken with great care and caution.

Most often, issues with respect to valid equity ownership arise out of equity programs associated with employee relationships with the alleged oppressing shareholders or enterprise. An example of this issue and its resolution can be found in *Willis v. Donnelly,* a 2006 Texas Supreme Court case.[16]

In *Willis v. Donnelly*, two business entities were incorporated by Willis for the purpose of operating a high-end day spa. Donnelly executed a letter agreement, whereby he would work in and manage the day spa. In addition, Donnelly provided employees and customers from his own hair salon business to the day spa. In exchange, Donnelly was paid a salary and was to be provided a 25% ownership interest when gross revenues attained the level of Donnelly's former company. The letter agreement also provided a clause requiring any shares granted under the agreement be sold back to the corporation in the event of his termination.

Ultimately, when the new company reached the level of gross revenue necessary to trigger the right to receive shares under the letter agreement, the day spa was not yet profitable, and the issuance of the shares was delayed. Donnelly later agreed to the delay, allowing Willis to realize the tax benefits of the losses.

[16] *Willis v. Donnelly*, 199 S.W.3d 262(Tex. 2006)

The case notes several actions that were taken by Willis against the economic interests of Donnelly after the date that Donnelly became entitled to the shares, including:

- Capital contributions were characterized and recorded as shareholder loans;
- All of Willis' shares were transferred to his wife;
- The land and buildings were purchased personally by Willis, even though the corporation had an option to acquire the same property; and
- The rent was increased to the operating company.

Donnelly was later terminated, having never received his shares as set out in the letter agreement. The matter ended up in Court, with Donnelly suing Willis and the corporation for breach of the letter agreement, specifically for not issuing the shares, and for breach of fiduciary duties to a minority shareholder. The Trial Court jury decided in favor of the Plaintiff and awarded damages under both claims.

On appeal, the Court of Appeals held that Willis owed Donnelly a fiduciary duty of conduct and had engaged in conduct found to constitute oppression. In ruling in this way, the Appellate Court found Donnelly to be a minority shareholder, based on evidence presented, including the letter agreement and testimony by Willis.

The State Supreme Court reversed the Appellate Court's finding as to Willis' failure to execute his fiduciary duty, noting that majority shareholder fiduciary duties arise solely as a result of having a minority shareholder (in this case, Donnelly) and, in this case, Donnelly was never issued the shares and was never a shareholder when any of the actions set forth in the complaint occurred. In effect, the Court ruled that there can be no liability for alleged breaches of a fiduciary duty before that fiduciary duty arises.

The authors have been engaged in the past as experts in a privately-held business case where "restricted" equity had been granted to employees in exchange for personal services. In this case, the equity interests granted were subject to vesting schedules. Unvested equity interests were found by the court in that action to not constitute actual ownership by the grantee employee.

Financial Expert Involvement

Once the issue of equity ownership is, in fact, determined (or at least addressed) the experience of the authors is that each averment or claim is then challenged by the majority equity owner's legal counsel. In many instances, the services of outside economic and financial experts are not required to advance these arguments. In others, however, the economic and financial experts can play a critical role in defeating the claims.

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Within the complaint filed by, or on behalf of, plaintiff, defendant's responding arguments may be made under any number of avenues. Often, the authors have observed counter-arguments that the alleged oppressing action set out in the complaint did not occur or, alternatively, that it did occur, but the action was taken in good faith and was fair. Other defense arguments that the authors have noted in cases in which we were engaged as experts include the protections afforded by the business judgment rule or that the actions were within the rights of the majority ownership.

In many cases, establishing the credibility of these defensive strategies requires that the economic and financial expert undertake forensic procedures intended to determine the facts and circumstances surrounding the alleged oppressive action and to evaluate the overall detrimental effect relating to the defeat of the minority equity owner's reasonable expectations in making the investment. While the foundation of each argument is based on legal theory and formulated by legal counsel, the "accounting" structure of the alleged oppressive action, as well as the quantification of the economic and financial effects associated with the identified action, is at the center of the financial expert's assignment and responsibility.

Note that the forensic aspect of any accounting or financial process is extremely detailed and requires significant effort. Oftentimes, the level of detail required to be reviewed, analyzed and considered to make a proper and credible determination is extensive. Additionally, availability of enterprise and minority equity owner operational and financial information is generally limited, especially in instances where the matters date back for many years (which is often the case as plaintiff's counsel attempts to establish a pattern of oppression over time).

The difficulties experienced by the authors, and other economic and financial experts, in supporting the legal community in undertaking assignments of this nature primarily revolve around three key elements detailed below.

1. The availability and accessibility of adequate historical information
2. The "start and stop" intervals associated with the overall legal process, where motions and hearings take place over distant time periods, causing a "rebooting" to move forward as each event occurs.
3. A lack of adequate time to properly conduct the services requested by counsel.

The first difficulty is obviously a more troublesome matter for the plaintiff minority equity owner, in that he or she does not have open access to the books and records of the business entity. However, as the minority equity owner has a definitive right to these records, and a failure to provide these records is, in and of itself, a cause of action for relief from oppression. The authors have observed the availability and accessibility of adequate historical information to be less problematic in oppression cases than in other litigation matters that require repeated motions to produce records. Nevertheless, the inability to obtain adequate information for any economic or financial assessment renders that assessment less credible than it might otherwise be, and at some level of availability, the limitations may result in the expert being unable to opine on the matter requested by counsel in the representation of his or her client.

"Start and stop" seems to be an unchangeable dynamic of the litigation arena, and it is difficult from the perspective of the authors to identify and set forth a means by which such starts and stops can be better controlled. The efforts of the experts, while conducted in an independent and objective manner, are still guided by legal counsel who, of course, hopes for those opinions that align with the legal strategy that he or she has devised for the matter at hand.

Often, the fluid nature of the legal process and the evolution of the case from initiation through trial preparation causes the necessity to temporarily halt the process or delay next steps until further legal considerations are completed. It is important to understand, however, that such halts and delays require a re-familiarization period to regain momentum on the part of the expert. Very often, the authors note that the ongoing effort is one of complete intensity or no activity. To the end of making the process more even, it is always more cost beneficial and effective to stay on assignment through completion. Where that is not possible, one might consider at least "compartmentalizing" requested economic and financial determinations and opinions in defined segments of the case. The authors have found such to be relatively effective in controlling expert efforts.

Lastly, the time required to undertake the proper determination and quantification of the economic and financial effects of alleged majority owner oppressive actions can be significant. Involvement in counsel's case at the earliest moment possible clearly leads to the best outcome possible. Development of credible expert evidence is at the heart of the expert's assignment and, depending on the complexity of the matter under consideration, can take significant time to complete. The authors have often been requested to assist in cases, especially smaller cases, with insufficient time allotted for the accomplishment of those procedures necessary to develop credible expert evidence.

The presentation of expert opinions, and the procedures and work undertaken to develop those opinions, are generally presented in a full, in-depth and self-contained report. The report is completed in accordance with governing professional standards and intended to allow the reader to not only understand the basis of the opinions offered by the expert, but also the means by which he or she came to the opinions rendered. The process of preparing the report in any litigation matter, including equity owner oppression, requires a carefully authored narrative that directly corresponds to the factual foundation of the case. In this effort, review of the report by legal counsel for factual accuracy is important.

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As will be noted in Chapter V, addressing the determinations of the economic and financial effects (including valuation effects) of alleged oppressive actions, the modifications to facts incorporated in the expert's analysis and report will be incorporated into the presentation. However, while factual information may be considered and reanalyzed, all elements of professional judgement associated with the expert assessment, including the procedures adopted and undertaken in the assignment, the analyses, and the final opinion, will remain the sole discretion of the expert.

Please note that these materials are not intended to provide legal advice of any kind or to supplant the role of legal counsel as the leader in the effort to represent his or her client. The authors, through this chapter and throughout these materials, intend only to share those experiences and nuances that we have encountered in cases where we have served as experts.

IV. Case Law Examples

Within this chapter, we will provide a sampling of minority oppression cases decided primarily in the Commonwealth of Pennsylvania. As opinions in a number of cases cite, and as discussed earlier in these materials, Pennsylvania has adopted the "reasonable expectations" test to define oppression. Pennsylvania Courts recognize that there is no oppressive conduct if a minority shareholder has unreasonable expectations. Statutory remedies for oppression can include judicial dissolution, the appointment of a custodian for the business and the appointment of a receiver. Additionally, in situations of a profitable business with the ability to continue on with management acting without conflict, the courts in Pennsylvania have ordered the buyout of minority shareholders at the "fair value" of their shares.

One notable case from the State of Virginia is also included herein. In 2013, this landmark case brought the rights of minority shareholders, the duties of controlling shareholders and limitations of certain "perceived" protective measures to justify actions on the part of the controlling shareholders to the forefront.

Note that this chapter is not intended to be an all-inclusive representation of current case law in the jurisdictions presented, and the decisions are obviously based on the jurisdictional statutes under which the cases were filed. Statutes and case law governing this area often differ from state to state. However, there are certain foundational concepts and trends in matters of shareholder oppression that tend to be at the forefront, regardless of where the issue is litigated.

Shareholder Oppression Actions vs. Dissenting Shareholder Appraisal Rights

Pennsylvania first passed a dissenting shareholder appraisal rights statute in 1901. Any fundamental corporate change (i.e. merger, recapitalization, the sale of substantially all of the corporate assets or other major changes to the nature of a shareholder's investment in the corporation) in the State of Pennsylvania requires board action, a notice to shareholders and the approval by a majority of the shares actually cast on the issue.

The Business Corporation Law of 1988 (BCL) generally provides appraisal rights to dissenting shareholders who wish to request an appraisal of the value of their shares, under 15 Pa. C.S. §§1930 and 1578 (2012). The remedy in a statutory dissenting shareholder appraisal rights case is that the shareholder will receive cash in exchange for his or her shares.

As noted throughout the material, shareholder oppression actions generally result from shareholders of closely-held corporations who claim to have been treated unjustly or prejudicially by the controlling shareholder(s).

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The alleged oppressed shareholder has the burden of proving that the controlling shareholder(s) intentionally excluded him or her from the proper share of the benefits of his or her investment in the corporation. As noted above, numerous remedies are available for oppression actions.

Both shareholder oppression and dissenting shareholder actions are based on state statutes, and both rely on the fair value standard of valuation. Based upon the specific claims or allegations against controlling shareholders in connection with actions of shareholder oppression, these cases are more personal than dissenting shareholder claims, as the dissenting shareholder rights are enacted upon a financial decision by a corporation. In every instance, the financial expert, or valuator, will rely on the specific instructions of legal counsel regarding the direction of the case.

Adler v. Tauberg, 881 A.2d 1267 (Pa. Super. Ct. 2005)

A Pennsylvania Appellate Court upheld an Order of the Court of Common Pleas of Allegheny County appointing a 50% shareholder (Adler), director and president of a closely-held Pennsylvania corporation, as custodian to manage the business affairs of the corporation pursuant to 15 Pa. C.S. §1767 after finding oppression.

At trial, Adler sought appointment of a custodian on the basis of the Defendant's alleged illegal, oppressive and fraudulent conduct, causing the assets of the closely-held Pennsylvania Corporation to be misapplied and wasted. Adler further alleged that the Defendants wrongly attempted to issue stock and change the rules of governance of the corporation to his detriment. In granting Adler's motion for appointment of a custodian, the Trial Court concluded, inter alia, Appellants "had unjustly exercised authority and power over [Adler] with respect to the corporate affairs of the Corporation."

On appeal, the Defendants argued that the Trial Court record did not support the need for the appointment of a custodian, as the evidence presented was insufficient to sustain a finding they had acted illegally, oppressively or fraudulently within the meaning of the statute.

The Court came to the following factual conclusions:

- The three other directors were attempting to issue stock and change the rules of governance for the corporation to the detriment of the corporation and Adler, who was a director and president of the corporation.
- Beginning in October of 2002, the Defendants began to request that Adler retire from the practice and resign from his position as president.

- The Defendants initially demanded that Adler's salary be reduced by one-third, then demanded that his contractually guaranteed salary be revoked and his compensation be tied to his production.
- The other members of the corporation attempted to divert patients from Adler.
- On November 5, 2003, the other shareholders attempted to issue corporate shares to another doctor. When the corporation's counsel advised that a previous written agreement restricting the transfer of corporate shares may have precluded the issuance of these shares, the vote was tabled. On November 18, 2003, Defendants, each owning 25% of the shares, voted to increase the number of board members from 3 to 4 and fill the new board seat with another doctor. The Defendants then voted to make themselves officers and pay each of them an additional $50,000 for serving as officers. This had the effect of reducing Adler's compensation by $37,500.
- The Defendants then fired the corporations' long-time legal counsel and replaced him with their attorney.
- The Defendants approved a resolution that paid their personal attorney's fees with corporate funds.
- The Defendants effectively removed Adler's power to write checks on the corporation's bank accounts. The Defendants wrote corporate checks for items which Adler did not agree.

As a result of considering the evidence, the Trial Court concluded that the ongoing disagreements between the parties negatively affected the functioning of the corporation and could have endangered patient care.

In deciding the appeal, the Superior Court of Pennsylvania Appellate Court held that under 15 Pa. C.S. §1767, a Trial Court may appoint a custodian for a corporation upon application of a shareholder when: "[i]n the case of a closely-held corporation, the directors or those in control of the corporation have acted illegally, oppressively or fraudulently toward one or more holders or owners of 5 percent or more of the outstanding shares of any class of the corporation in their capacities as shareholders, directors, officers or employees."

The Court noted that oppressive conduct in this case took the form of freezing out a minority shareholder by removing him from his various offices or by substantially diminishing his power or compensation.

The Court recognized that there are three different definitions of "oppressive" conduct utilized by Courts throughout the country. They are:

1. Oppression as 'burdensome, harsh and wrongful conduct, a visible departure from the standards of fair dealing and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.

2. Oppression is linked to the term directly to breach of the fiduciary duty of good faith and fair dealing majority shareholders owe minority shareholders, a duty that many courts recognize as enhanced in a close corporation setting.
3. Oppression is tied to frustration of the reasonable expectations of the [minority] shareholders.

The Court found that Pennsylvania employs the "reasonable expectations of the shareholders" test, which is the same test used by New York and New Jersey Courts. In finding the same, the Superior Court upheld the Trial Court's findings that Adler was oppressed. As such, it affirmed the Trial Court's appointment of a custodian to manage the day-to-day affairs of the corporation.

This decision is important for three reasons. First, the Court found that a 50% owner was found to be an oppressed minority shareholder, despite the fact that he controlled half of the company. The Court recognized that, although Adler held half of the stock, he was being controlled by the other two shareholders who collectively owned the remaining 50% of the corporation's shares. Second, a custodial receiver may be appointed pursuant to Pennsylvania law if oppression or deadlock is found. Third, the Superior Court used the "reasonable expectations of the shareholder" test when determining shareholder oppression.

Viener v. Jacobs, 834 A.2d 546 (Pa. Super. Ct. 2003)

In *Viener v. Jacobs*, the Trial Court concluded that Jacobs, as majority shareholder, owed a fiduciary duty to Viener, as minority shareholder, and that Jacobs' conduct in "freezing out" Viener was outrageous and oppressive. Therefore, the Trial Court concluded that Jacobs was liable to Viener for compensatory and punitive damages resulting from the breach of fiduciary duty to Viener. On appeal, Jacobs questioned the Trial Court's findings and determination of damages. The Court affirmed the Trial Court's judgement in part, but remanded for a proper valuation of the companies at issue and, thus, a recalculation of damages.

For more than 50 years, George P. Viener (Viener) and his father were in the textile business in the Reading, Pennsylvania area. Neal Jacobs (Jacobs) was employed by the Viener family business and was eventually offered a 20% ownership interest in the business. Viener and Jacobs began producing garments for a company that employed Norman Rush (Rush), a college friend of Viener. Together, Viener, Rush and Jacobs started their own company, NGN, Inc. (NGN), a Subchapter S textile corporation, on January 1, 1983. The three each owned a 33⅓% interest in NGN. Viener served as president/secretary/treasurer while Jacobs and Rush served as vice presidents. All three were subject to a shareholder agreement that guaranteed that each shareholder could sell his shares to the other shareholders at the current book value of NGN.

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In 1994, Viener expressed concerns regarding questionable cash payments authorized by Jacobs, whose duties were to manage manufacturing and quality control. The payments in question were made by NGN to one of its subcontractors, N.V. Sportswear, and its majority shareholder, Kim Van Vu (Van Vu). Initially, Viener acquiesced to the cash payments upon the advice of Michael Joffred (Joffred), then NGN's auditor.

At that time, Rush indicated that he wished to make Joffred an officer in the company; a plan initially, supported by Viener. Shortly thereafter, Jacobs and Rush voted to remove Viener as president of NGN against his wishes and demoted him to vice president. Joffred replaced Viener as president of NGN. Eventually, Joffred suspended NGN's practice of making cash payments to subcontractors. Nevertheless, in late 1994, at Jacobs' direction, Crown-Globe, Inc., another NGN subcontractor, generated what proved to be false invoices to reflect "price adjustments" to NGN. Thereafter, Jacobs caused NGN to pay the funds to Crown-Globe, who in turn re-paid Jacobs. Jacobs then paid the funds directly to Van Vu.

Viener questioned Joffred regarding the cash payments. At trial, Joffred confirmed that the invoices were fraudulent and were an inappropriate attempt by Jacobs to divert cash payments to Van Vu and N.V. Sportswear in direct violation of corporate policy. Thereafter, Joffred prevented NGN from paying to Crown-Globe a second series of invoices.

Viener was then voted out of his position as vice president of NGN by Jacobs and Rush, on Joffred's recommendation. Evidence presented at trial indicates that Joffred intended to fire Viener as vice president for "wasting people's time with questions." Viener remained on NGN's board of directors after being fired, but his participation on the board was severely limited.

Following Viener's termination, NGN ceased its regular practice of quarterly board meetings, Viener was only permitted access to NGN's facilities during hours of regular operation, and employees of NGN were warned that if they spoke to Viener, they would be fired. Finally, Viener was excluded from voting on issues of employee compensation because Jacobs and Rush established a committee, consisting of all of the other shareholders, directors and Joffred, to handle those matters.

Following Viener's termination, the sales of both NGN and its affiliated company, Reading Garment Co., Inc. (RGC), declined and they sustained substantial losses. At this time, NGN loaned textile equipment valued at approximately $218,000 to Amex, a corporation in Mexico, at Jacobs' request. This equipment was collateral for a loan held with CoreStates Bank, and the loan documents with the bank prevented the transfer of these assets. Moreover, despite dwindling capital accounts, Jacobs withdrew over $200,000 from his loan account for the purpose of purchasing the equipment loaned to Amex. Neither the equipment purchased, nor the funds used to purchase the equipment, were returned to NGN by Jacobs. Instead, part of the equipment located at Amex was transferred to Kimmex, a second facility in Mexico owned by Jacobs and Van Vu. The balance of the equipment at Amex was sold, and the funds acquired from the sale were reinvested in equipment for Kimmex.

While the Kimmex transactions were taking place, Jacobs allowed his responsibilities at NGN to lapse. As a result, a major client of NGN demanded that Joffred take over responsibility for quality control because of its concerns regarding the quality and timeliness of deliveries. Joffred took over quality control from Jacobs, but NGN's viability continued its rapid decline, and the company ceased operations on August 31, 1997.

On appeal, Jacobs questioned the Trial Court's determination that Viener was frozen out of NGN, and that Jacobs breached his fiduciary duty. However, the Trial Court refused to apply the business judgment rule to Jacobs' conduct. Jacob's remaining claims challenged the Trial Court's determination of damages.

In response to these items, the Court found that the Trial Court did not abuse its discretion with respect to the facts that it found. Jacobs, in conjunction with Rush, acted to "freeze out" Viener, the minority shareholder, from obtaining a proper share of the benefits that accrued from the enterprise. As found by the Trial Court, after Viener complained about Jacobs' practices to Joffred, he [Viener] was removed from his position of responsibility and prevented from providing a role in the governance of the corporation, which his expertise helped build. Following Viener's termination in 1995, his primary means of access to the company's financial documents was via a discovery order from the Trial Court and through periodic financial statements.

Further, under the direction of Jacobs, NGN's assets and opportunities were squandered, while the company was experiencing a financial crisis, through mismanagement and conduct designed to benefit Jacobs and his confidant, Van Vu. The Court found that this evidence alone was sufficient to demonstrate that Jacobs (and Rush) froze out Viener from a meaningful role in NGN's operation. The Court also found that the Trial Court was correct when it determined that the business judgement rule did not insulate Jacobs (and Rush) from liability for freezing out Viener.

In response to Jacobs' challenges to the Trial Court's determination of damages including the claim that Viener failed to prove the extent and amount of damages resulting from Jacobs' actions, the Court found that the Trial Court did not err when it calculated the compensatory damages applicable to Jacobs. However, the Court found that the expert upon whom the Trial Court relied to determine the value of NCN and RGC did not have sufficient facts on which to base his opinion of value and, accordingly, the Trial Court's assessment of damages was erroneous.

Thus, the Court affirmed the judgment in part, but remanded for a proper assessment of the value of NGN and RGC, and a recalculation of damages.

Economic & Legal Considerations in Shareholder/Equity Owner Oppression

Ford v. Ford, 878 A.2d 894 (Pa. Super. Ct. 2005)

William K. Ford (Bill), individually and as president of Riverview Golf Course, Inc., and Riverview Golf Course, Inc., a closely-held Pennsylvania corporation (hereafter "Riverview" or "the Company"), on appeal from the order entered on June 7, 2004. The Trial Court found that Bill acted oppressively toward minority shareholders by engaging in self-dealing and by excluding the minority from any benefits of Riverview, which owns and operates the Riverview Golf Course, an 18-hole course that includes a clubhouse, driving range, practice green and pole barn for the golf carts.

At inception, the Company had four shareholders, including William B. Ford (William), husband of Plaintiff Margaret B. Ford (Margaret), and father of Plaintiff Margaret L. Ford (Peggy) and the Defendant (Bill). At some point, three of the initial shareholders bought out the fourth, leaving William as the majority shareholder and President of the Company.

Bill began operating a golf cart business and a pro shop at the course as sole proprietorships in 1969, utilizing Riverview employees to staff these businesses. Bill did not reimburse the Company for space his business occupied or the cost of the employees. While William acted as President of the Company, Bill and Peggy were employed by the golf course.

In 1988, two other shareholders sought to dissolve the Company, and sued William. The case ultimately settled, with William loaning money to the Company to fund the buyout the other two shareholders. The Company initially paid only interest, but made regular payments on the notes. Bill also contributed money to fund the buyout, and William gave Bill enough stock to make him the majority shareholder of Riverview, although William remained the President.

In 1992, the Company subdivided a small parcel of its property and sold it to Bill, who in turn, built a house on the parcel. Although the home was owned by Bill, the grounds around the house were maintained by the Company's employees, and utilized the Company's water supply, which is pumped directly from the Monongahela River at no cost to Riverview.

After William's death in 1995, Bill became President of Riverview and, shortly thereafter, he fired Peggy. Bill then hired his wife and son, and both were elected to the Company's board of directors. Additionally, upon William's death, Margaret inherited William's stock, making her a minority shareholder of the Company. Peggy was also a minority shareholder at this time.

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In 1997, Margaret and Peggy filed a suit against Riverview, claiming Bill was using the Company for his own benefit, to the detriment of the minority shareholders. The case settled, with the Company borrowing funds to pay Margaret the balance of the notes to her as William's beneficiary.

Bill continued to own and operate the pro shop and cart business separately, but began paying the Company for the use of its assets. In 2002, Bill lent additional funds to the Company for improvements to the clubhouse and course, and for the repayment of the bank note taken to pay Margaret for the settlement. At the time, these debts were the only debts of the Company.

Margaret and Peggy, still feeling as if they were treated unfairly, again filed a complaint against Bill and Riverview, claiming that Bill continued to manage the Company for his own benefit while oppressing the minority shareholders, and asked this court to appoint a custodian. Prior to trial, Margaret gave her shares in Riverview to Peggy and Evan Ford, the brother of Bill and Peggy.

During a non-jury trial, the court found that Bill had financially benefited himself, his wife, and his son to the detriment of the minority shareholders of the Company. The Court found Bill's conduct oppressive, warranting the appointment of a custodian. However, a settlement was not reached, and the Defendants appealed.

On appeal, the court concluded that the Trial Court could have reached the factual conclusions it did on the evidence presented. The record reflects that Bill engaged in self-dealing by paying a nominal sum to the Company, in exchange for the right to personally reap all of the profits from the lucrative pro shop and golf cart businesses. As previously noted, the Trial Court found that Bill's businesses took in substantial funds, but Bill remitted only a fractional amount in rental and labor fees to the Company. The Court found that in doing so, Bill effectively siphoned off income that should have inured to the benefit of the Company as a whole. The Court found that at the same time, Bill took no steps to provide any benefits to the minority shareholders. Thus the Trial Court found that Bill acted oppressively.

Thomas E. Leech v. Robert M. Leech, No. 846 WDA 2000 (2000 Pa. Super. Ct. 334)

In April 2000, Robert M. Leech (Robert) appealed an order appointing a certified public accountant as custodian of Leech Tool & Die, Inc. (Leech Tool & Die). Appellee, Thomas E. Leech (Thomas), initiated the action for the appointment of a custodian, which was appointed by a Trial Court.

Thomas and Robert are brothers who each owned 50% of the stock of Leech Tool & Die. They were the only directors and officers of that corporation. Thomas acted in the capacity of secretary/treasurer, and Robert as president.

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On September 29, 1995, Leech Tool & Die entered into certain agreements with Leech Industries, Inc. (Leech Industries). Leech Industries was formed for the purpose of becoming the operating company of the business formerly operated by Leech Tool & Die, enabling the children of both parties to take over the operation of the business.

In 1997, there was a disagreement between the children who owned Leech Industries. At this time, Thomas and Robert had discussions to resolve the matter jointly. After these discussions, Thomas opted to leave the company. However, there was no specific discussion as to what his departure meant. Thomas claimed that he was simply quitting his employment at Leech Industries, and was not resigning from his position as secretary/treasurer of Leech Tool & Die. It is important to note that he returned to the company after one year.

During his absence from the Company, Thomas no longer had any income. There were no distributions of assets or income from Leech Tool & Die, even though it had funds, or could access funds from Leech Industries, to make distributions.

Also, after Thomas left his employment, the bank where Leech Tool & Die had its accounts was given a corporate resolution that the only signature authorized on checks of Leech Tool & Die was that of Robert. As such, Thomas could not sign checks, even though he was still the secretary/treasurer. Up to this point, he had been signing checks. That resolution was never adopted by the Board of Directors and, therefore, was ineffective.

The bylaws of Leech Tool & Die provide that the treasurer has custody of corporate funds, must keep full and accurate records, and shall deposit all monies in the name of the Company in depositories designated by the Board. Furthermore, the treasurer shall disburse funds of the Company as may be ordered by the Board. Thomas, as the elected treasurer of Leech Tool & Die, did not perform any of those functions after he left the employment of Leech Industries. However, Thomas was still the secretary/treasurer of Leech Tool & Die.

The case presented two issues for the Court:

1. Could a shareholder holding a 50% interest in a closely held corporation be oppressed?
2. Did the Trial Court abuse its discretion in appointing a custodian on the grounds of oppression?

Robert argued he acted reasonably in believing Thomas's one-year absence from his position as secretary/treasurer of the Company served as his permanent resignation. He also argued the appointment of a custodian injured the Company because it deprived the parties of the right to conduct the Company's affairs and burdened the Company with additional expenses. Further, Robert argued that Thomas, a 50% owner of the

Company, could not be oppressed because they were equals. Additionally, because the parties share equally in the corporate decisions, Robert argued, there was no opportunity for him to overreach his powers and injure Thomas. Thus, there was no need for a custodian.

The Court found that Robert and Thomas were no longer equal in their share of control over the Company and, in fact, Robert exercised exclusive control over Leech Tool & Die during the time Thomas left his position. Further, the Court found that Robert took steps to diminish Thomas' decision-making ability. Moreover, the Court found that Robert's actions during and after Thomas' absence were clearly an unjust exercise of authority.

Upon Thomas' return to his position, Robert unjustly burdened him in his position. Robert refused to allow Thomas to return to his former office space to perform his duties and did not allow Thomas access to corporate records. Robert removed Thomas' authority to sign corporate checks and gave the authority to a non-officer. Robert also moved Leech Tool & Die's corporate account, so that Thomas could not have access. Finally, Thomas was not given the income that was promised from Leech Tool & Die, without explanation.

The Court concluded that Robert's actions did constitute oppression, and that the trial court did not abuse its discretion in appointing a custodian.

Bair v. Purcell, Civil Action No. 1:04-CV-1357. (M.D. Pa. Mar. 17, 2009)

In 1998, Defendant Francis Purcell (Francis) incorporated Defendant Appalachian Baking Company, Inc. (Appalachian Baking) under Pennsylvania law as a closely-held business corporation. That same year, Appalachian Baking entered into a 10-year franchise agreement with the Atlanta Bread Company International, Inc., pursuant to which Appalachian Baking was granted exclusive development rights for Atlanta Bread Company stores in various areas in Pennsylvania and Maryland. At the time, Francis was the sole shareholder of Appalachian Baking.

Prior to their involvement with Appalachian Baking, Plaintiffs Curtis Bair (Curtis) and his wife, Patrice Bair (Patrice), lived and worked in Atlanta, Georgia. Curtis and Francis were friends and had previously worked together, primarily on a Peachtree Pretzel Time, Inc. franchise. Curtis held a 10% ownership in the franchise, and both he and his wife worked for the operation. In 1998, Francis informed Plaintiffs that he had decided to pursue an Atlanta Bread Company franchise, and Curtis agreed to allow him to use part of their equity in Peachtree Pretzel Time to pay the franchise fee and other start-up expenses of Appalachian Baking. During this time, Plaintiffs claim that Francis represented to them that he planned to open 10 to 15 Atlanta Bread Company stores, and that Plaintiffs would play a long-term role in the company.

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In June 2000, Francis sent Curtis a packet of documents to be circulated to potential investors in Appalachian Baking. The documents included a confidential descriptive memorandum that stated that the company planned to "operate one or more retail bakery and café restaurants under the name Atlanta Bread Company" within their exclusive development territory. The packet also contained a form shareholder agreement, dated June 1, 2000, that listed Curtis as a shareholder in the company and as a member of the Board of Directors.

However, the corporate records of Appalachian Baking contain a different June 1, 2000, shareholder agreement. This agreement lists Francis as the sole shareholder of Appalachian Baking, although an attached exhibit lists Francis and his wife, Norma Purcell (Norma), as co-owners of 100% of the company's 77 shares. Notwithstanding the other differences between this agreement and the form shareholder agreement contained in the packet of documents provided to potential investors, this agreement still listed Curtis as a member of the Board of Directors and provided that all board members must be shareholders.

On June 7, 2000, Appalachian Baking entered into a 10-year lease for a restaurant. Subsequently, friends of the Purcells purchased six shares of the company's stock, and Norma's sister and brother-in-law purchased two shares of the company's stock. On February 5, 2001, Norma became co-owner of Francis' majority shareholding in Appalachian Baking. On August 8, 2001, the company issued 15 shares of stock to Curtis at no cost.

Investors in Appalachian Baking had an expectation that a full $500,000 would be raised for initial operation of the company. After the investments made in mid-2000, there was still a $360,000 shortfall in this initial operational capital from unsold shares. The initial offering to investors had a provision that any unsold shares would be purchased by Francis. Instead, Francis and Norma loaned Appalachian Baking up to $238,000, rather than making a capital investment in the company by purchasing shares. The loan was repaid to the Purcells from the company, without attending to any of the formalities of a dividend and not allowing other shareholders to participate.

On May 22, 2001, Appalachian Baking held its first shareholders and board meeting, during which the officers and directors of the company were elected. However, the company's records contain no minutes from this meeting, and the corporate records indicate that the company's officers and directors were elected at a shareholders meeting held on December 20, 2001. According to the December minutes, Francis, Norma and Curtis were elected as directors of the company, and named as officers – Francis, president and treasurer; Norma, vice president; and Curtis, secretary.

Appalachian Baking's first (and only) Atlanta Bread Company restaurant opened in July 2001 in Harrisburg. Despite the successful opening, the store manager became unhappy with his position and resigned due to the demands and conflicts with Jessica Purcell (Francis and Norma's daughter), an employee under his supervision. As a result, and at the request of Francis, Curtis quit his job in Atlanta and relocated to Pennsylvania to assist with operating the restaurant, under the title of vice president of store operations. Patrice began working at the restaurant as a catering coordinator in August 2001.

In early 2002, Francis and Curtis began to disagree about the direction of the company. Curtis expected to grow the company quickly and to open additional restaurant locations throughout the exclusive development territory. However, on April 9, 2002, Francis informed Curtis that he was not planning to open any more restaurants, and that he wanted to retire from the company. In early May 2002, Francis announced his intention to sell his and his wife's controlling interest in the company to his daughter, Jessica Kiely (formerly, Jessica Purcell).

Plaintiffs allege that on May 2, 2002, Francis offered to purchase Curtis' shares of stock in the company, and that Curtis verbally accepted the offer. Defendants contend that Curtis offered to have his stock redeemed by the company, but an agreement was never finalized.

On May 10, 2002, Francis prepared a stock-purchase letter addressed to the other shareholders, wherein Francis stated that he was planning to purchase Curtis' shares and sell his and his wife's controlling shares to Jessica. In addition, the letter confirmed that Francis would assume the corporation's current debt. Finally, in the letter, Francis offered the other shareholders following four options: (1) purchase a proportional share of Curtis' 15% interest; (2) purchase a proportional share of Francis' 77% interest; (3) sell their shares to the company for their initial purchase price plus 10% interest compounded over two years; and/or (4) keep their current ownership in the company. The shareholders agreed to sell their shares to Appalachian Baking.

On July 20, 2002, Appalachian Baking held a joint meeting of the shareholders and members of the Board of Directors, wherein Francis used his controlling interest to vote that the company would redeem the other shareholders' stock pursuant to the aforementioned letter, but would not redeem Curtis' stock. Curtis offered to sell his shares to the other shareholders, but each declined his offer.

In August 2002, Curtis' and Patrice's positions were eliminated, and their employment with the company was terminated. In September 2002, Francis, on behalf of Appalachian Baking, terminated the company's exclusive development rights agreement with Atlanta Bread Company International.

In January 2003, Francis requested that Curtis sign two letters of resignation that he prepared, seeking Curtis' resignation from the Board of Directors and as corporate secretary. Curtis refused to sign either letter. On November 13, 2003, Curtis issued a letter demanding that the company, or Francis, purchase his 15 shares of stock pursuant to their stock buyout agreement, and that the company satisfy the unpaid wages owed to

Patrice. Thereafter, Francis directed the company's attorney to schedule a combined special meeting of the company's shareholders and Board of Directors. At that meeting, Francis used his controlling interest to amend the company's bylaws to reduce the number of members on the Board of Directors from three to two, and to remove Curtis from his Board position. The two new Directors were Francis and his daughter, Jessica. They were also elected as officers, along with Oliver Kiely (Jessica's husband). Curtis attempted to object to the voting, but was advised that he was not entitled to participate in the election of officers since he was no longer a member of the Board of Directors.

Based on these facts, the Court found that there was ample evidence that Francis and Norma did not satisfy their obligation of the utmost good faith and loyalty to Curtis as a minority shareholder.

The Court found the indicator of a classic minority shareholder freeze out was the extent to which Francis and Norma misused the corporate process to substantially infringe on Curtis' proper share of corporate benefits. Between August 25, 2002, and December 12, 2003, Curtis was fired from his position at the restaurant, removed as corporate secretary, and voted off the Board of Directors. The Court found that there was not a legitimate reason for these actions. Curtis' term on the Board of Directors did not expire by its own terms, as was argued by the Defendants, and his service as a Board member was terminated in a manner contrary to the existing shareholder agreement, which provided that he would be a permanent Board member as long as he remained a shareholder. Further raising the specter of a purposeful corporate freeze out, Jessica took over Curtis' job at the restaurant and his positions in the corporation after he was removed.

Appalachian Baking also did not pay any dividends to its shareholders. Given the threats made by Francis, the returns of Appalachian Baking for the relevant years, and the Purcells' hostile actions towards Curtis, the Court found it was clear that the dividends were withheld to harm Curtis and not for any proper business purpose. As such, the Court found that Francis and Norma used their power as majority shareholder to improperly exclude Curtis from his proper share of corporate benefits.

Furthermore, the Court found that Francis and Norma appropriated corporate assets by accepting "loan payments" on money "loaned" to Appalachian Baking to make up the initial shortfall in start-up operating capital. The offering to potential investors provided that the Purcells would make up any shortfall by capital investment in the corporation, which could only be recovered by undergoing the formal process of declaring a dividend. All shareholders would have had a right to a dividend in proportion to their ownership in the company, as represented by their number of shares. By loaning the money to Appalachian Baking, the Purcells undermined the legitimate expectation of the investors. As a loan, it also accrued interest and was considered a corporate obligation. The Court found that this conduct unfairly disadvantaged the corporation and resulted in an appropriation of corporate assets from Appalachian Baking.

This appropriation also lends further support to the finding discussed above that Francis purposefully ensured that dividends were withheld to harm Curtis and without a legitimate business purpose. While the Defendants argued that it was in Francis' best interest as a majority shareholder to see that Appalachian Baking paid out dividends, the Court found it to be clear that under this loan arrangement Francis could profit from the company without letting Curtis participate.

Moreover, the Court found that Francis improperly restricted Curtis' access to corporate records. Francis misled Curtis by giving him a copy of a two-page document titled "keys to bylaw inserts" when he asked for a copy of the bylaws. Further, the corporate attorney initially denied Curtis' request for a copy of the shareholder agreement in order to get clearance from Francis, even though Curtis was a corporate officer and Board member at the time.

Finally, the Court found that Francis and Norma also excluded Curtis from any meaningful role in corporate decision-making. Even before his total removal, the Purcells made it impossible for Curtis to effectively participate in Board and shareholder meetings. Curtis' ability to participate in the decision-making was also impacted by the difficulty he encountered even in simply gaining access to certain essential corporate documents.

The Court found that Francis intentionally engaged in outrageous and reprehensible conduct in violating Curtis' rights as a minority shareholder. Francis manipulated the corporate process to freeze out Curtis without regard to his rights as a minority shareholder. The Court found that the intentional and malicious character of Francis' conduct was aptly demonstrated by his fraudulent attempts to disguise the freeze out process in altering the original shareholder agreement and surreptitiously altering corporate records of a transfer of stock to his daughter in contravention of the shareholder agreement and bylaws of the company.

The Court found that beyond ignoring Curtis' rights as a minority shareholder and manipulating the corporate process, Francis utilized his power, status and authority to marginalize and intimidate Curtis, mainly in an effort to stop him from contacting an attorney to ascertain or enforce his rights. He used his relationship with the corporate attorney to facilitate the freeze out. Francis also threatened to eliminate the value of Curtis' shares if Curtis got an attorney involved in their dispute. Francis even fired Curtis and Patrice from their jobs at the restaurant because Curtis was attempting to assert his rights as a minority shareholder. After Curtis' final shareholder meeting, Francis warned Curtis that he would not pay him a penny until ordered by a judge. As such, the Court perceives that Francis' proposals to settle the dispute or compensate Curtis were not made in good faith but, rather, to further delay Curtis from pursuing legal options.

Lastly, the Court found that Norma took no action as a majority co-shareholder to protect Curtis' rights. Though the Defendants argued that she had no personal role in the matter, the Court found it to be clear that she involved herself in the negotiation process for the buyback of Curtis' stock. She also joined in her husband's attempts to stop Curtis from hiring an attorney. The Court found that Norma had maliciously violated Curtis' rights, and accordingly, found Norma to be equally responsible and blameworthy for this conduct.

For the foregoing reasons, the Court entered judgment in favor of Plaintiff on his breach of fiduciary duty/shareholder oppression claim.

Staiger v. Holohan, 100 A.3d 622 (Pa. Super. Ct. 2014)

A Pennsylvania Appellate Court found that a Trial Court could order the dissolution of a profitable Pennsylvania Limited Liability Company (LLC).

Plaintiff Staiger and Defendant Holohan formed two Pennsylvania LLCs. Both Plaintiff and Defendant owned 50% of both LLCs. Staiger lent one of the LLCs $165,000 to be used as start-up capital. The members agreed in writing that Staiger would be repaid the start-up funds within five years.

Operating agreements for both of the LLCs contained identical language, which set forth that the members have the authority to make business decisions, and the decisions of a majority are controlling. Shortly after forming one of LLCs, the members executed an agreement that provided that another unnamed LLC of Holman's was to manage one of the LLCs for a fee, for an initial term of five years, and the arrangement would then continue for two additional five-year periods.

The business relationship between Staiger and Holohan deteriorated to the point where, in 2006, they agreed in a series of emails to dissolve their partnership. Despite agreeing that they no longer wanted to continue doing business together, the two partners were unable to negotiate a buyout. After that point in time, Holohan continued to unilaterally operate both companies, to the extent that Staiger neither received any further money from the businesses, nor information regarding their operations. Holohan refused to repay Staiger for his initial investment, as was agreed to by both parties, and Holohan caused the LLCs to pay for his personal legal fees without Staiger's consent.

Despite the fact that the two LLCs were profitable, the Court ordered a dissolution pursuant to 15 Pa. C.S. §972. In support of that decision, the Court reasoned that there was "deadlock" amongst the members, as both parties each owned half of the companies. As such, neither member could unilaterally make management decisions without running afoul of the operating agreements, which required "majority rule." The Court found that Staiger presented evidence that he was wrongfully excluded or "frozen out" from managing the LLCs, and reasoned that Holohan's unilateral decisions to have the LLCs pay his personal legal expenses and fees violated the operating agreement (which required majority approval).

This decision is important because it provides Pennsylvania Trial Court with guidance as to when they should order a judicial dissolution pursuant to 15 Pa. C.S. §972. Further, the Court did not permit the oppressor to use the fact that the LLCs were profitable as a hurdle to dissolution.

Colgate et al v. The Disthene Group, 2013 WL 691105, 85 Va. Cir.286

In August 2012, Judge Jane Marum Roush, sitting by designation in the Circuit Court of Buckingham County, issued a comprehensive letter opinion in this case, which reassessed a substantial portion of the law governing the duties of majority shareholders. This landmark case strengthened the rights of minority shareholders in closely-held companies, holding controlling shareholders accountable for their abusive actions.

In their lawsuit, the Plaintiffs sought the extraordinary remedy of corporate dissolution under §13.1-747 of the Virginia code. A circuit court is empowered to dissolve a non-public Virginia corporation if it finds, among other things, that the directors have acted in a manner that is illegal, oppressive or fraudulent, or if it finds that corporate assets have been wasted or misapplied. The Supreme Court of Virginia has held that, in this context, "oppressive" means "a visible departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely."

Gene Dixon Jr. (Gene) and his son, Guy, owned all of the voting stock (capital structure included both voting and nonvoting stock) of The Disthene Group, Inc. (Disthene), which at the time of litigation was a successful, and diversified Virginia-based holding company. Its subsidiaries included the Cavalier Hotel Corporation in Virginia Beach; Kyanite Mining Corporation, one of Virginia's oldest mining companies and the world's largest producer of the minerals kyanite and mullite; and significant land holdings in Blue Rock Resources, a Virginia LLC. The publicly-filed settlement agreement estimated the total value of the Disthene Group, Inc. at approximately $200 million.

The controlling shareholders consistently elected themselves and those closest to them as officers and directors of Disthene and its subsidiaries. Most of the non-voting shares not owned by Gene and Guy were owned by descendants of the company's founder, Gene Dixon Sr., who were relatives of the controlling shareholders.

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Minority shareholders owning 42% of the outstanding shares brought suit, alleging that the controlling shareholders had engaged in a pattern of oppressive and fraudulent conduct designed to disadvantage the minority shareholders and had misapplied and wasted corporate assets. The defense primarily focused on the "business judgment rule" in an effort to demonstrate that their actions were supported by sound business practices. The business judgment rule insulates directors of a corporation who "discharge their duties in accordance with good faith business judgment of the best interests of the corporation." However, this defense only applies when controlling shareholders exercise business judgment on behalf of the *corporation*, rather than engaging in behavior or transactions that place the interests of the controlling shareholders above the interests of the corporation.

The Judge found that the business judgment rule did not apply as a defense in this case because decisions were not made in good faith to benefit the interests of the corporation. Rather, the Judge found that the controlling shareholders engaged for decades in the following breach of fiduciary duties:

- Provided misrepresentations and half-truths with respect to the value of the company stock when negotiating with minority shareholders selling their shares back to the company
- Favored the interests of their own family members at the expense of the nonvoting shareholders
- Materially increased compensation for certain controlling owners
- Reduced dividends paid to minority shareholders in retaliation against the filing of an earlier lawsuit
- Misused or wasted corporate assets by using them for personal purposes without fair compensation to the company

Based upon the above-noted behavior on the part of the controlling shareholders, valuation analysts and forensic accounting experts played an integral role in analyzing the information and provided opinions to support the merits of the claims asserted by the Plaintiffs and, ultimately, the opinion of the Judge.

As a result, the Judge agreed to provide the remedy mandated by Virginia law by ordering the judicial dissolution of Disthene. The controlling shareholders appealed, but the case settled in August 2013, before the Virginia Supreme Court could review the matter.

The settlement resulted in the buyout of the minority shareholders' stock for approximately $77 million. The settlement amount, as well as the cost of litigation (including expert fees, legal fees, including the Plaintiffs' and receivership fees), had a significant impact on the financial position of Disthene, such that the historical hotel held by one of the subsidiaries was sold to pay for the settlement.

A significant portion of the Judge's letter opinion was devoted to setting forth and analyzing common techniques of the oppression of minority shareholder. These "squeeze out" techniques included withholding dividends or keeping dividend payments artificially low in order to force minority shareholders to sell the shares at considerably less than actual value, and awarding unreasonable jobs, salaries, pay-raises and bonuses to the majority shareholders or their family members. The opinion reassessed a substantial portion of the body of law governing the duties of majority shareholders in closely-held corporations.

Concluding Thoughts

The cases presented herein illustrate the actions on the part of majority shareholders, as well as the remedies ordered by the respective courts. Pennsylvania courts have looked to other jurisdictions, like Delaware and New Jersey especially, when it comes to the application of fair value in the buyout of an oppressed shareholder. The following is a listing of additional cases that may be of interest:

- *Cavalier Oil Corp v. Harnett*, 564 A.2d 1137 (Del. 1989)
- *Crosby v. Beam*, 47 Ohio St. 3d 105 (1989)
- *Michael D. Kieffer v. Charles A. Budd,* A-2030-15T4 (N.J. Super. Ct. App. Div. 2017)
- *Willis v. Donnelly*, 199 S.W.3d 262(Tex. 2006)
- *Boehringer v Konkel*, 404 S.W.3d 18 (Tex. App. – Houston [1st Dist.] 2013)
- *Ritchie v. Rupe,* S.W.3d 275 (Tex. App. – Dallas 2011), rev'd 443 S.W.3d 856 (Tex. 2014)
- *Del Borrello v. Del Borrello*, 62 Pa. D. & C.4th 417, 429 (Pa. Com. Pl. 2001)
- *Baron v. Pritzker*, 2001 Pa. Dist. & Cnty. Dec. LEXIS 447 (Pa. 2001)
- *Orchard v. Covelli*, 590 F.Supp. 1548, 1560 (W.D. Pa. 1984), aff'd, 802 F.2d 448 (3rd Cir. 1986)
- *Lorain Natl. Bank v. Saratoga Apts.* (1989), 61 Ohio App.3d 127, 130, 572 N.E.2d 198.
- *Estate of Schroer v. Stamco Supply, Inc.*, 482 N.E.2d 975, 981 (Ohio App.3d 1989).
- *Masinter v. WEBCO Co.*, 262 S.E.2d 433, 438 (W. Va. 1980)
- *Tri-State Petroleum Corp. v. Coyne,* No. 17-0009 (W. Va. Apr. 12, 2018)
- *Weinberger v. UOP,* 457 A.2d 701, 710 (Del. 1983)
- *In re Glosser Bros.,* 555 A.2d 129, 134 (Pa. Super. Ct. 1989)

V. Valuation in Oppression Actions

In the context of shareholder oppression cases, the valuation of the company typically poses one of the most critical issues requiring resolution. As previously noted, there are aspects of business valuation that are unique to equity owner disputes, which must be understood and considered by the business valuator. Failure by the valuator to consider these nuances can have a profound effect on the conclusion and create issues in resolving a dispute.

In shareholder oppression cases, many valuation issues are fundamental and administrative in nature. That is, a determination must be made by legal counsel (and the valuator) as to the appropriate date of valuation, standard of value and premise of value to utilize based upon the specific circumstances of the case. These determinations are made after considering various factors such as the governing documents and legal precedent.

To the extent that a company's governing documents, whether it be an operating agreement, shareholder agreement, buy-sell agreement or bylaws, speak to shareholder oppression, these legal documents will take priority over statutory guidance and case law. These documents represent an agreement between the owners as to how specific situations should be handled in the course of business. If the governing documents are silent with respect to valuation issues in oppression situations, state statutes and case law will carry the day.

This chapter addresses the issues that can arise in the various aspects of the valuation process.

Date of Valuation

Valuation of any asset, including an ownership interest in a business enterprise, is performed as of a specific point in time, which is referred to as the "date of valuation." The determination and utilization of the appropriate date of valuation is critical as value changes over time. Any issues that impact the earnings potential of a business will have an impact on the value of an ownership interest in that business. Examples include changes in the expected future revenue, increased competition within the industry, operational issues or statutory changes, such as a change in the tax code. The date of valuation impacts the information available for consideration by the valuator. It is the perspective from which all analysis is performed.

Generally, the purpose of the valuation project will determine the appropriate date of valuation. For instance, in the estate planning realm, the date of valuation can be strategically determined by the taxpayers and their advisors. In a shareholder oppression case, however, the date of valuation is usually determined by the court, legal statute, court filing or within the corporate documents. For this reason, valuators often lean on legal counsel for guidance on the appropriate date of valuation to be used in the representation of their client.

While legal counsel will, ultimately, have the final say in the determination of the appropriate date of valuation, generally it will be one of a few specific dates, depending on the facts and circumstances of the particular case. In the event that the company's governing documents exist and speak to the issue, attorneys and valuators can look to their provisions as guidance for the proper date of valuation. It is not uncommon for these documents to speak to a specific point in time in which the business can generate 'clean' financial data, such as a year-end or month-end.

If no guidance exists in the governing documents of a business, the date on which the oppressed equity owner files a complaint with the court can be used as the date of valuation. This date is utilized, as it is the date at which the oppressed party made it formally known that he/she believes he/she has been wronged. Shareholder oppression, by nature, can occur over a period of time, not necessarily at one specific point in time. For example, if a corporation has not paid dividends because a controlling shareholder takes a salary that is above reasonable compensation, the oppressive act has likely happened for multiple years. In such instances, the court may need to consider the impact of various dates to determine the most appropriate effective date to use.

In *Viener v. Jacobs*, 834 A.2d 546, 556 (Pa. Super. Ct., 2003), the court determined to use a date of valuation predating a post-squeeze-out decrease in the company's value, as it was determined to be in the best interest of the oppressed shareholder.

If valuation professionals are engaged on each side of an oppressed equity owner dispute, it is important that each uses the same date of valuation. Whether the date is agreed to by the shareholders, or determined through governing documents or legal precedent, consistency in application between valuation professionals is critical. Inconsistency between valuators in which date is utilized will render their opinions incomparable, and will require additional professional time to remedy – generally at the expense of the parties to the action.

Standard of Value

The "standard of value" is nothing more than a definitional explanation of different, commonly utilized types of value. However, it is one of the most controversial and critical aspects of the valuation. It is incumbent upon the business valuator and legal counsel to fully understand the ramifications and implications of each definition. The word "value" can take on different meanings depending on the context of the valuation assignment. Application of an inappropriate standard of value will have a direct impact on the reliability of the opinion of value.

While it is generally the role of the business valuator to fully explain and educate legal counsel as to the definition and nuances of each standard of value, it is the attorney's role to dictate the standard of value that is required in conjunction with his/her case. This is especially true where judicial history subject to legal interpretation sets the precedent.

The standards of value most commonly encountered are:

- Fair Market Value
- Investment/Strategic Value
- Fair Value (for financial reporting)
- Fair Value (under state statues)
- Intrinsic/Fundamental Value

The standard of value for equity owner oppression cases is generally governed by state law. The two standards that are primarily utilized in relation to shareholder oppression cases are fair value and fair market value (or a variation thereof). As discussed earlier, in the Commonwealth of Pennsylvania, the Pennsylvania Code is often cited as the source for valuation-related issues. 15 Pa. C.S §1572 states that the value of an oppressed shareholder's ownership interest is equal to:

> *"The fair value of shares immediately before the effectuation of the corporate action to which the dissenter objects, taking into account all relevant factors, but excluding any appreciation or depreciation in anticipation of the corporate action."*

Many states look to the 1984 Revised Model Business Corporation Act for guidance on many valuation-related issues. The guidance was revised in 1999 to read:

> *"Fair value, with respect to dissenter's shares, means the value of shares immediately before the effectuation of the corporate action to which the dissenter objects using customary and current valuation concepts and techniques generally employed for similar businesses in the context of the transaction requiring appraisal, and without discounting for lack of marketability or minority status except, if appropriate, for amendments to the certificate of incorporation pursuant to section 13.02."*

While fair value is often the standard used for equity owner oppression cases, the definition of fair value is usually set forth in its relation to fair market value from a conceptual standpoint. That is, in most cases, fair value is understood as the fair market value of a specific ownership interest, without consideration of discounts for lack of control or lack of marketability, as these adjustments would be inequitable. Said another way, fair value can be defined as the minority interest's pro-rata share of the value of the company as a whole. The implication in the latter definition is, again, that adjustments for lack of control are not considered as to prevent unfairly enriching the controlling shareholder.

Economic & Legal Considerations in Shareholder/Equity Owner Oppression

The following chart[17] describes the differences between the fair value and fair market value standards.

Fair Market Value	Fair Value
Willing buyer	*Not always a willing buyer*
Willing seller	*Not a willing seller*
Neither under compulsion	*Buyer not always compelled; seller under compulsion*
Assumes a typical hypothetical buyer and seller	*The impact of the proposed transaction is not considered; the concept of fairness to the seller is a possible consideration*
A price equitable to both	*A concept of "fairness" to the seller, considering the inability to keep the stock*
Assumes buyer and seller have equal knowledge	*No such assumption*
Assumes reasonable knowledge of both parties	*No such assumption*
Applicable to both controlling interests and minority blocks	*Applicable only to minority blocks*
Applies to all federal tax valuations	*The most common value standard in state dissenting and oppressed shareholder statutes*

Fair market value is an objective standard, while fair value is an equitable standard. Note that in the event that organizational documents that govern the standard of value exist, they may direct the business valuator to the agreed-upon standard of value. However, if the valuation assignment is related to a shareholder oppression suit, Pennsylvania law plainly provides that oppressed shareholders/equity owners are entitled to the "fair value" of their equity interests.

Using the fair value standard, as opposed to the fair market value standard, will result in a higher value to the minority shareholder. However, the value under the fair value standard will still be less than the value determined under a strategic or synergistic value standard, which takes into account buyer-specific synergies unattainable by the Company in its current form. As such, the fair value standard strikes a balance between

[17] Trugman, Gary R. *Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses.*

awarding a controlling shareholder who forced out a minority shareholder (if the fair market value standard were used) and incentivizing litigation by a non-controlling shareholder attempting to capture value from controlling shareholders, which is unattainable without synergistic acquisition (under a strategic value standard).

Selecting the correct standard of value and applying it properly is critical in a valuation assignment, as each standard will yield different opinions of value. The standard of value dictates the methodologies that will be performed, as well as the discounts and premiums that may be applied. This is often challenging in a litigation setting, as the correct standard of value varies depending on the nature of the case. As a result, it is important that legal counsel is consulted regarding the standard to be used.

Premise of Value

Another determination that must be made for a valuation assignment related to an equity owner oppression case is the applicable premise of value. The "premise of value" is an assumption regarding the most-likely set of transactional circumstances that may be applicable to the subject valuation. Premises of value include either *going concern* or *liquidation*.

Most often, valuation professionals work under the "going concern" premise of value, meaning that the existing management of the subject company will remain into the future and will maintain the character and integrity of the company. Rooted in this premise of value is the assumption that the ongoing operations of the business, and the cash returns generated by those operations, drive the value of the company. This premise of value most-closely aligns with the concept that all value is forward-looking and that the value of any investment is the present value of all future benefits that will accrue to it.

A liquidation premise would provide the net amount that would be realized if the business was terminated, and the assets were sold piecemeal. Liquidation can be either *orderly* or *forced*. In certain instances, equity owner oppression cases can result in the dissolution of a company. Though rare, in some cases the court orders that a company be dissolved, even though it had a history of strong performance of profitability. In most states, a shareholder buyout option is preferred to dissolution. Thus, the going concern premise of value is generally utilized.

It should be noted, however, in Pennsylvania, the court has allowed the dissolution of a business if it is in the best interest of the oppressed shareholder. According to15 Pa. C.S. §1981, if "the acts of the directors, or those in control of the corporation, are illegal, oppressive or fraudulent and that it is beneficial to the interest of the shareholders, that the corporation be wound up and dissolved." While this does not necessarily directly impact the valuation of the equity owner's business interest, it should be considered by the oppressed shareholder in understanding his or her options in resolution of an oppression case.

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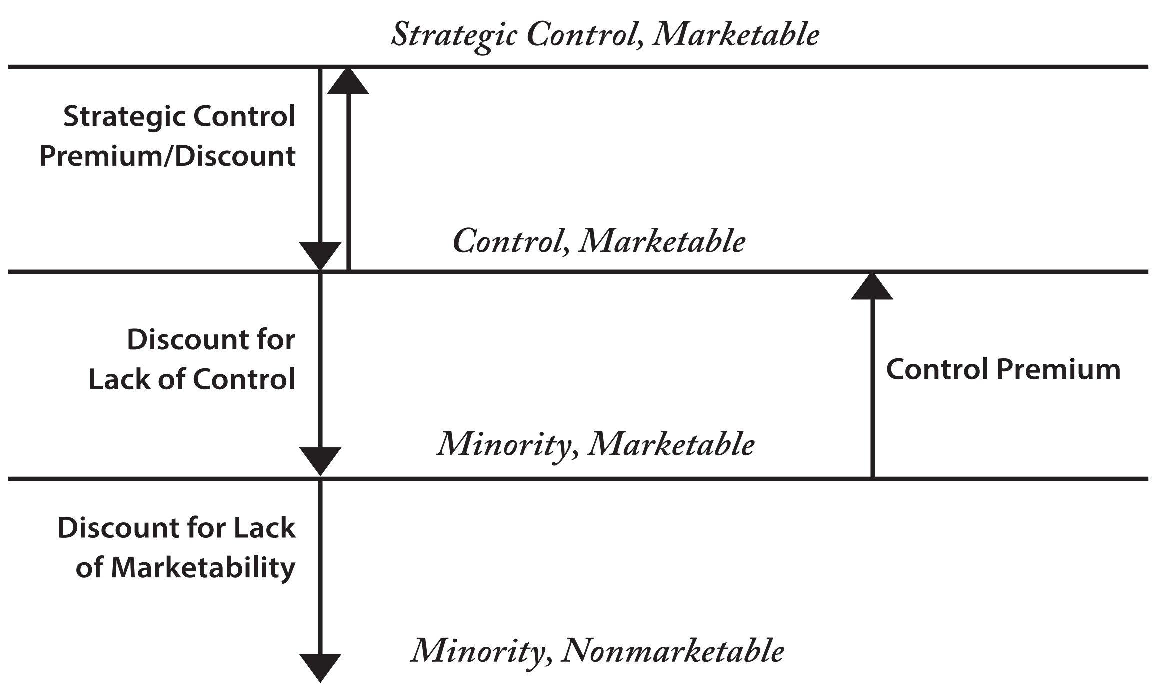
Valuation Adjustments – Normalization Adjustments

As previously noted, the fair value standard is usually interpreted as fair market value, without adjustments for non-controlling ownership attributes. In practice, this requires a valuator to value the business on a control level of value. To calculate a control value under the income and market approaches to valuation, the benefit stream or earnings stream utilized in the calculations must be the earnings stream available to a control owner.

LEVELS OF VALUE – EXPANDED MODEL



To adjust the historical or forecasted benefit stream to a control level, the valuator will look to specific adjustments to the income statement that could only be made by a controlling shareholder. Usually, this involves adjusting excess expenses incurred by the company as a result of the decision of the controlling shareholder. Common control adjustments include:

- ***Adding back excess compensation paid to the controlling shareholder*** – As discussed earlier, in small businesses, business owners often also serve as management within the company. The owner may take compensation that is above what the business would need to spend for a replacement employee. The difference serves to decrease the amount available to distribute to all owners of the business.

- ***Adding back compensation paid to a related party, at the direction of the controlling shareholder, that is not active in the operations of the business*** – In family run businesses, it is not uncommon to see family members compensated as employees, when the services that they provide to the company do not warrant the level of compensation that they earn. In some cases, family members are listed as employees and receive compensation when they perform no services to the business. As this serves to decrease the amount available to provide a return for an investor, the compensation should be added back to income.

- ***Adding back fringe benefits that are outside the normal compensation package for a particular position within the company*** – In a closely-held business, benefits and perquisites that are paid for by the business can include cell phones and plans, vehicle leases, parking leases and medical coverage, among others. If these benefits are more costly to the business than those that would be provided to a replacement employee, the difference should be added back to income.

- ***Adding back the portion of rent that is paid to a related party that is above market value for a similar space or facility*** – It is common practice to place real estate owned by a business owner into a separate legal entity. This entity will then charge the business rent for use of the property. Setting the rent above market value provides the business owner with a means to divert funds from a business disproportionately from the other shareholders of the business. If rent is above market rates, the difference serves to decrease the funds available to be distributed to all owners of the business.

Each of the above-noted adjustments would result in a normalization adjustment that is an add-back to historical or forecasted income. Capitalizing a normalized benefit stream that is higher than the GAAP income will result in a higher value, thus, compensating the minority shareholder.

It should also be noted that for each of these adjustments, a separate calculation of damages could be undertaken by the valuator. If the specifics of the case require that the oppressed equity owner be compensated for damages related to any of the above noted items, rather than have their ownership repurchased, the valuator can quantify the damage on an item-by-item basis. Note, further, that the tax impact of these adjustments must be considered in this calculation in the same way that it is considered in a valuation of the minority shareholder's ownership interest.

Valuation Adjustments – Discounts/Premiums

When determining the value of any ownership interest in a business, the valuator must consider the specific ownership attributes of the subject interest. The specific bundle of rights associated with the ownership interest will impact what a knowledgeable investor would pay for the interest due to the inherent risks resulting from the bundle of rights. In consideration of the specific ownership attributes of an equity instrument, valuators routinely determine whether it is appropriate to apply specific discounts or premiums to the value calculated under each of the three broad valuation approaches (income, market, and asset-based).

Depending upon valuator inputs into the mathematical models under the various approaches, each may produce a valuation conclusion that differs in relation to the subject equity interest. That is, the application of a discount or premium may be warranted to bring the calculated value under the applied approach to the targeted or required level of value.

The attributes most commonly addressed by discounts or premiums are related to control, or lack thereof, and those related to a lack of liquidity or marketability. A minority interest lacks the ability to control the operations of the business without the support of additional shareholders. Additionally, a minority interest in a privately-held business lacks the ability to quickly liquidate ownership interest. For these reasons, valuators often must determine if a discount for lack of control and a discount for lack of marketability/liquidity are applicable.

It is important to note that, by themselves, discounts and premiums do not exist. That is to say, these items are not traded on an open market, nor is there discernible direct evidence as to the proper level of discount or premium to use in any specific instance. In effect, "discounts and premiums" are the "fallout" of using "less-than-perfect" market data to measure value.

To the extent that a buy-sell agreement or other governing document requires the application of the fair market value standard, discounts for lack of control and lack of marketability may be applied to a minority equity ownership interest in closely-held businesses. However, if the governing documents are silent with regards to shareholder oppression or the standard of value, state statute will carry the day. As noted earlier, while many states use a similar conceptual standard of value for equity owner oppression cases, the application of discounts can vary from one state to another.

In most fair value cases, discounts are not applied when calculating the value of a minority ownership interest. However, depending on the jurisdiction, the following has been observed when applying fair value:

- Disallowing both discounts;
- Allowing both discounts;
- Allowing only a discount for lack of control; and
- Allowing only a discount for lack of marketability.

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In Pennsylvania it has been observed that in employing the fair value standard, valuations appear to calculate fair market value without the consideration of either a discount for lack of control or lack of marketability. As is often the case, the onus is on the valuator to educate legal counsel on the nuances of valuation adjustments, but the final determination of their applicability will fall in the hands of counsel.

Conclusion

Various issues in equity owner oppression cases need to be considered at the onset by legal counsel and the valuator. It is important for legal counsel to understand not only the various issues at play, but also the potential impact of these issues to the clients and their cases. Determining the proper standard of value, and the methods that will be applied, are critical to an efficient valuation determination. For these reasons, legal counsel and the valuator must work together throughout the case to ensure the best possible outcome for clients.

VI. Conclusion and Practical Considerations

Any dispute among shareholders, partners or members that involves acts of oppression can result in an expensive and time-consuming process of litigation or dispute resolution. As has been discussed, parties to such affairs end up disputing each other's conduct and the "fair value" of their equity interests. The resulting expense is not only the prospect of a buyout order at fair value, which can represent substantially more than fair market value (due, principally, to the non-recognition of discounts for lack of control and/or lack of marketability), but also the expense of valuation experts, forensic accountants and, of course, legal representatives.

More importantly, the toll on the human capital of the business, customer relations, employees and operations, as well as reputations, can be devastating. Rumors and news of owner discord can generate a firestorm of discontent among all of the stakeholders in the business operation. By way of example, the authors have observed loss of customers and employees due simply to the discomfort of continuing to be involved with one side of the matter versus another.

And, in the end, perhaps the most disheartening outcome in the privately-held business context, especially for family-owned businesses, is the potential impairment or destruction of long-term relationships. In many instances, those unrelated-party, privately-held ownership groups came together out of prior relationships and technical skillsets deemed complementary to one another. The overriding elements of joining together to pursue a business endeavor are often trust and respect. Family businesses are, likewise, often built on trust and respect, but include an added attribute of a bond that runs deep due to familial relationships and, oftentimes, long histories of business success carried on from one generation to the next. In both cases, these relationships are put at great risk as a result of minority equity owner oppression and the pursuit of a legal resolution to the alleged majority "bad" actions.

The cost of saving relationships does not, however, need to extend to absorbing significant economic losses as a result of oppressive decisions and actions by those equity owners wielding control in any business enterprise. Any investment activity is an "at risk" proposition. The purchase of a minority equity interest is no exception. However, activities undertaken by insiders to the detriment of the business enterprise or the equity owner group very often compound that risk and make the investment untenable. In the end, that is exactly what protections afforded under shareholder and equity owner oppression statutes, as well as judicial decisions in favor of minority equity owner plaintiffs are intended to guard against.

Economic & Legal Considerations in Shareholder/Equity Owner Oppression

While Texas law does not control legal decisions in the Commonwealth of Pennsylvania, a recent case took an expanded view of "reasonable expectations" of investors. In *Ritchie v. Rupe*,[18] a Dallas Court of Appeals opinion affirmed a lower court buyout order. In the opinion, the appellate court offered the premise that there are two types of shareholder oppression.

The first type was labeled "specific expectations," which require specific facts [which] gave rise to the expectation in a particular case, and that the expectation was reasonable under the circumstances that drew the investor to purchase an equity interest in that business venture.

The appellate court set the second type of reasonable expectation as "general expectations," and opined that these expectations arise from the mere status of being a shareholder and [that they] belong to every shareholder unless there is evidence to the contrary under applicable law.

While the opinion of the Texas appellate court may, at first, seem at odds with the standard utilized in the Commonwealth, it appears logical and reasonable. The dichotomy of the two types of reasonable expectations identified in this decision illustrates an example of the constantly evolving and fluid nature of oppression cases.

On the flip side of the minority equity owner protections are those rights accorded majority owners, which allow them to operate the business enterprise as they deem appropriate without interference from those equity owners that hold a non-controlling equity interest. Just as the lack of control conveys investment risk and a value detriment to the minority owners, the element of control inherent in the majority ownership position assumes that the same risk is not present in the majority shares and, as such, those shares carry less risk and are valued higher.

Majority equity owners generally maintain the exact same rights and interests as the minority equity owners. Obviously, the latter is not in a position to defeat the reasonable expectations of the majority equity owners. However, it is important to remember that the fundamental rights accorded majority equity owners are not superseded by those same rights of the minority equity owners.

As such, many majority equity owners' decisions and actions may constitute nothing more than reasonable, fully-informed, and prudent business undertakings that are determined by the majority equity owners to benefit the enterprise and the equity owner group as a whole. Such actions are, of course, permissible. This includes outvoting minority equity owners on decisions with which they do not agree.

The authors continue to see a broad range of majority equity owner activities being challenged through claims of oppression. The breadth of such claims appear to affect businesses of all sizes, and the authors are not

[18] *Lee C. Ritchie v. Ann Caldwell Rupe*, 339 SW 3d 275-Tex: Court of Appeals, 5th Dist. 2011

able to identify any discernible trend related to the growth in the number of these cases other than minority owner perceptions. As such, we often advise majority owners to exercise due care in their operational decisions and, where possible, include adequate communications with minority equity owners to ensure clarity.

Grossman Yanak & Ford LLP's Business Valuation and Litigation Support Services Group can provide a wide range of economic and financial capability in the arena of shareholder disputes in general and, specifically, with equity owner oppression matters. Examples of our general service capabilities on the forensic side of these assignments include the design and application of procedures to identify and quantify:

- Misuse of enterprise assets
- Theft of enterprise assets
- Fraudulent business transactions
- Diverting enterprise income or profits
- Equity owner malfeasance relating to compensation, rent, expense reports and theft
- Redirecting enterprise opportunities to the benefit of the majority equity owners

Beyond our general forensic capabilities, Grossman Yanak & Ford LLP is one of the region's most highly regarded Business Valuation firms and is often called upon to assist in cases both in this region and nationally. Our experience and expertise ensures that the determinations and opinions of value established through the application of our procedures provides your clients with defendable conclusions of value of the highest quality. The types of valuation assignments we undertake in connection with equity owner disputes include:

- Equity interest valuation
- Business enterprise valuation
- Analysis of economic impact of governing documents, including buy/sell agreements, shareholder, partner and limited liability company operating agreements
- Quantification of discounts for lack of control and marketability, if applicable
- Analysis of applicable employment contracts
- Analysis of applicable non-compete agreements

Of course, we are also able to provide expert witness services and have significant experience working with mediators and testifying in both federal and state courts.

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We are always ready and willing to share our thoughts about the facts of your case. We will also meet with you and your client, at no charge, to allow an opportunity to better understand the process we would envision utilizing in assisting with your case.

Thank you again for sharing your valuable time with us. We appreciate the support that you and others participating today have given us over many years. We hope the information that was provided today will allow each of you to return to your practices a little better prepared to serve your clients and with some new ideas on how to address matters of equity owner oppression.

Should you have specific questions or comments, please feel free to speak to any of the authors after the session or feel free to contact any of them at a later time. Their contact information is included in Chapter I of these materials.

Have a great day!

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