Jurisdiction and Choice of Law in Minority Oppression Cases

by Stuart L. Pachman

Many states, including New Jersey in 1974, have amended their business corporation statutes to provide remedies for minority oppression. The ultimate relief authorized is a judgment dissolving the corporation. When the corporation has been formed in a state different from the forum state, questions of jurisdiction and conflict of laws arise.

The Minority Oppression Statute

Before addressing those issues, a brief discussion of what has come to be known as New Jersey’s corporate minority oppression statute is in order. The New Jersey Business Corporation Act, at N.J.S.A. 14A:12-7(1)(c), authorizes the New Jersey Superior Court, Chancery Division, upon competent proof of minority oppression, to appoint a custodian, appoint a provisional director, order a sale of the corporation’s stock, or enter a judgment dissolving the corporation. The statute was adopted to remedy the situation where, in a small corporation where there is no market for the corporation’s shares, a minority, treated unfairly by a controlling majority, was unable to exit the enterprise. Partnership law traditionally afforded an unhappy partner in a general partnership the ability to dissolve the partnership at will. An unhappy corporate minority shareholder, where there was no market for his or her shares, had no similar power and consequently was locked in. The statute affords judicial assistance to minority shareholders who believe themselves to be oppressed. It strikes a balance between: 1) the right of the majority to manage the corporation as it sees fit with 2) its “duty of fairness” to the minority.

The following is an oversimplified example illustrating the operation of the statute.

A corporate majority, with or without good reason, removes the minority (plaintiff) from the board of directors and reduces the plaintiff’s compensation as an employee. The
plaintiff has neither the votes to effect change within the corporation nor, as a practical matter, the ability to sell his or her shares to a third party. The statute authorizes the plaintiff to file a complaint in the Chancery Division of the superior court for relief, which may include a judgment of dissolution. Without admitting the plaintiff’s allegations, the defendants may move to buy the plaintiff’s shares. If the court grants the motion, the case devolves into a proceeding to determine the fair value of the plaintiff’s shares. If the defendants choose not to move to buy out the plaintiff (or in the unlikely event the motion were not granted), the plaintiff is required to prove the allegations of the complaint. If the plaintiff fails, no relief is afforded. If the plaintiff proves his or her case, the court will grant appropriate relief, which can take various forms including, possibly, dissolution of the corporation.

This is not a problem where the domicile of the corporation is the same as the state in which the court is situated. But what happens when the state of incorporation differs from the forum state?

Hypothetical (But Not Unusual) Facts

When Mary, Moe and Jack were discussing the idea of going into business together several years ago, before limited liability companies became the vehicle of choice for ‘small’ business, a well-meaning but ill-advised acquaintance told them they should incorporate in Delaware, the home of large well-known corporations. The three New Jersey residents formed MMJ Corp. in Delaware, leased a location in New Jersey, and opened for business.

MMJ Corp. prospered, and 25 years later Mary and Jack continue to plug away, but Moe no longer wants to work as hard. As a result of his frequent absences, Mary and Jack have begun making business decisions without him. They have also increased their compensation in relation to Moe’s.

Moe considers himself oppressed and would like to avail himself of New Jersey’s minority oppression statute. MMJ Corp, however, is a Delaware corporation, and the Delaware General Corporation Law does not have a similar statutory provision. Moreover, a longstanding principle of corporate law, the internal affairs doctrine, provides that only the state of incorporation should regulate matters that pertain to the relationship between and among the corporation, its shareholders, directors, and officers. The reason behind the doctrine is that only one state should have the authority to regulate a corporation’s internal affairs, so the directors and officers know what law will be applied to their actions and the shareholders know by what standards management will be measured. A century ago, New Jersey’s then highest court “emphatically” repudiated the idea that a New Jersey court had jurisdiction regarding the management of the internal affairs of a foreign corporation. Thus, the first question is whether the internal affairs doctrine is a bar to the New Jersey court taking jurisdiction of Moe’s claim.

If New Jersey has jurisdiction, the next question is whether the New Jersey minority oppression statute or Delaware law is to be applied.

Finally, if New Jersey has jurisdiction and New Jersey law is applied, and if dissolution is the appropriate remedy, may a New Jersey court enter a judgment dissolving a foreign corporation?

Jurisdiction

The jurisdictional bar imposed by the internal affairs doctrine began to erode in New Jersey as early as 1925. A few years later, Vice Chancellor John O. Bigelow noted the rule in most states is that where the court has personal jurisdiction over the necessary parties, it may grant relief even though the suit involves the internal affairs of a foreign corporation. The question today is not whether the court has power to exercise jurisdiction but rather the wisdom of doing so. Prior to the enactment of N.J.S.A. 14A:12-7(1)(c), where a receiver was sought because of “dissenting existing between the majority and minority stockholders,” although the court denied the appointment of a receiver, it exercised its discretion to take jurisdiction where the business and assets of the foreign corporation were in New Jersey, all of the directors were before the court, and there were sufficient allegations of fraud or bad faith. In a minority oppression case, a New York court ruled that where a corporation was foreign ‘in name only,’ but most of the assets, employees, officers, and operations were in New York, it would exercise jurisdiction.

When drafting the New Jersey Business Corporation Act, the commissioners stated “our courts remain free under this revision...to retain jurisdiction in cases involving the internal affairs of a foreign corporation and to grant relief on equitable principles....” The ‘emphatic’ jurisdictional bar once posed by the internal affairs doctrine no longer prevails. New Jersey can take jurisdiction of Moe’s claim.

Choice of Law

The fact that a state may take jurisdiction does not necessarily mean the law of that state is applicable. One state may be an appropriate forum while another’s laws are the proper ones to be applied. In a case involving a New York corporation, where minority oppression was not the issue, the New Jersey Supreme Court affirmed the trial court’s application of New Jersey law because New Jersey had “more significant relationships to the parties and the transactions than New York.”

The internal affairs doctrine does not require application of the law of the state of incorporation where the forum
state has a more significant relationship to the parties. When the corporation does all, or nearly all of its business in the forum state, most of its shareholders are domiciled there, and the corporation has little contact with its state of incorporation, application of law other than that of the state of incorporation is justified. Some balancing is required.

The Claim for Dissolution

The question remains regarding the power to enter judgment dissolving a foreign corporation. Although acknowledging the ‘internal’ aspect of dissolution, courts have retained jurisdiction because a remedy short of dissolution could be fashioned. Indeed, the New Jersey statute and case law not only provide that remedies other than dissolution are authorized, but that they are favored.

The pure question of a forum state’s ability to order dissolution of a corporation of another state is not clear cut, but if all of the shareholders and all of the directors are before the court, the court should be able to order them to take steps to dissolve the corporation in the foreign jurisdiction and to oversee the liquidation and distribution of the enterprise.

The Unreported New Jersey Decisions

Minority oppression rights in foreign corporations have been addressed in two New Jersey decisions, neither of which is officially reported. One involved a Massachusetts corporation. The question was whether Massachusetts or New Jersey law should apply to the oppressed minority shareholder claim. Both the trial court and the Appellate Division found there was insufficient difference between the laws of the two states to warrant a finding that a conflict of laws existed, but ruled that on the facts New Jersey had a greater interest and its law should apply. The court applied a buy-out remedy, noting it had authority to fashion any remedy that ameliorated the wrongdoing.

Shortly thereafter, a minority oppression case involving a Delaware corporation was decided by Judge Peter Doyne in the Bergen County Chancery Division. The allegations, assumed to be true, were that the corporation’s principal place of business was in New Jersey; that its controlling shareholder, president and chief executive officer as well as members of its board of directors resided in New Jersey; and that corporate meetings were held, and corporate records maintained, in New Jersey. On a motion to dismiss, the court acknowledged that the internal affairs of a foreign corporation usually require application of the law of the state of incorporation, but that is not always dispositive. The court applied the New Jersey flexible ‘governmental-interest’ standard, which requires the application of the law of the state with the greater interest in resolving the particular issue.

Conclusion

In their treatise, Oppression of Minority Shareholders and LLC Members, professors F. Hodge O’Neal and Robert B. Thompson note that minority shareholders who acquiesce in their corporation being formed in Delaware may be placed at a disadvantage because Delaware law is oriented and drafted for the needs of large, publicly held corporations and, consequently, “business participants who seek to use it for their more intimate venture will find that Delaware statutes and judicial decisions give minority shareholders less avenues to contest majority conduct after there has been a falling out between the parties.”

Because of MMJ Corp.’s significant relationships with New Jersey, in spite of the unwise choice of corporate domicile he and his ‘partners’ made 25 years ago (and 25 years of unnecessary franchise fees paid to another state), it is the author’s opinion that Moe will be able to claim oppression under the New Jersey statute.

Stuart L. Pachman is a member of Brach Eichler L.L.C. in Roseland, where he is in general practice with an emphasis on business law. He is a director emeritus and former chair of the NJSBA Business Law Section, and the author of Title 14A Corporations, published by Gann Law Books, and numerous articles on business law. He was one of the three Business Law Section members who wrote the New Jersey Non-profit Corporation Act.

ENDNOTES

3. Cases that have been decided and the numerous issues raised by N.J.S.A. 14A:12-7(1)(c), such as who can be oppressed, what constitutes actionable conduct, procedural questions, remedies, valuation and application of discounts, and costs and counsel fees are discussed in Pachman, Title 14A Corporations, Chapter 12, Commentary 2 (Gann 2016 ed.).
6. Baldwin v. Berry Automatic Lubricator Corp., 99 N.J. Eq. 57, 60 (Ch. 1926), where, although the court acknowledged that resort must be had to the state of incorporation for regulation of a corporation’s internal affairs, certain relief may be granted when the corporation is engaged in business in New Jersey and has property here.
11. Commissioners’ Comment – 1968 to N.J.S.A. 14A:13-2. This comment, however, preceded the subsequent enactment of N.J.S.A. 14A:12-7(1)(c), author-
izing a judgment of dissolution where minority oppression is established.

12. Restatement (Second) of Conflict of Laws, Section 313 (1971).

13. In Dohring, the matter was settled after the court retained jurisdiction but before the conflict of laws issue was determined.

14. Francis v. United Jersey Bank, 87 N.J. 15, 27-28 (1981). It may be noted that the parties also agreed New Jersey law should apply.

15. Restatement (Second) of Conflict of Laws, Section 302, comment g. Delaware appears to be more inclined to find the laws of the state of incorporation apply. Rosenmiller v. Bordes, 607 A.2d 465, 468-469 (Del. Ch. 1971).


22. In In re U.S. Eagle Corporation, 484 B.R. 640 (Bkcy. D. N.J. 2012), on the procedural history the court applied Florida choice of law principles, with the result that the law of Delaware, the state of incorporation, was applied. The connection to New Jersey appears tenuous. Although the Delaware corporation’s headquarters was in New Jersey, it operated through three wholly owned subsidiaries that had their principal place of business in California.