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Issues to Consider When Taking on New Business Partners

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Many business owners have been lucky enough to avoid a dispute with their business partners and have no concern about shareholder dispute litigation. But what happens when the owners of a business decide to offer equity to others and take on new investors? If the new investor is going to put in so much capital that they take a controlling interest, the issues are vastly different. But when you take in a new minority owner – by giving equity to an employee, for example – the dynamics of the business relationship are inevitably going to change.

Before deciding to offer equity, you must understand two things:

- The first is that the new minority owner (or member, if an LLC) will have all the rights afforded under the New Jersey Shareholder's Protection Act's oppression statute. Under that statute, the rights you hold as a minority shareholder, such as management decisions, voting, employment with company, and equitable pay may be protected. Any actions by the majority shareholders to disrupt these rights may be considered oppression and may be subject to legal action. (To better understand what these rights are, read below).
- The second thing is that **these rights cannot be waived**.

Many clients are unaware of this, or think they can work around it. They want to draft a shareholders' agreement requiring the new minority owner to waive at least some of the rights set forth under the statute. But it simply can't be done. Even if the new owner signs such an agreement, the waiver will not be enforced. Worse still, the very act of asking that these rights be waived could be interpreted as a pretty disingenuous way to start off a new business relationship. I have heard minority owners ask, "what is going on in the company that they want me to agree in advance not to sue them for oppression?" I have also had many business owners tell me that the minority owners have "waived their rights" under the shareholder agreement that the owner prepared themselves – with help, of course, from the internet. Unfortunately, the "do-it-yourself" owner is likely to end up owing more money on a legal defense than they saved by not using a lawyer at the outset.

There are things you can do as a majority shareholder to combat this, such as bringing the new "owners" on as economic interest holders only – meaning that they get a percentage of the profits without actually being an owner. Of course, there may be valid business reasons why this will not work for you or your employee. But whatever you do, do it with your eyes wide open after you have consulted the appropriate business attorney.

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