**Business Divorce – From Prenup to Break-up**

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## JUDICIAL DISSOLUTION OF CORPORATIONS, LLCs AND LPs - ONE STATE'S RECENT EXPERIENCES

When a "business divorce" appears to be inevitable, the owners of the business typically would be well-advised to try to negotiate an agreement among themselves whereby one or more of the owners buys out the other owner(s) or all owners agree that the business be sold to a third party. In such a transaction, the selling owners will receive a negotiated payment for their shares while the business continues under different ownership and management. In some cases, however, one or more of the owners either cannot or will not agree to such a sale transaction. This could be due to any number of factors, including a particular owner's financial situation, the desire to retain control over the business, or simply personal animosity toward the other owner(s). If one owner's refusal to cooperate in the ongoing management of the business prevents the business from carrying on, the statutory remedy of judicial dissolution may be an option.

Below is an overview of the judicial dissolution landscape as it has developed over the last several years in Massachusetts. This is not a nationwide survey and parties should, of course, refer to their own state's statutes and case law when making or responding to a claim for judicial dissolution. Nonetheless, the Massachusetts statutes discussed here are based on the Model or Uniform Acts for the relevant entity. Thus, the decisions described below may be indicative of how courts in other states would approach claims made under comparable statutes. In any event, many of the business and personal conflicts that preceded the filing of the lawsuits described below are common to closely held businesses, wherever located.

At least in Massachusetts, courts have appeared generally reluctant to order a judicial dissolution except in the rarest and most straightforward cases. Instead, the decisions indicate a tendency of courts to deny the requested relief but to encourage the parties, either explicitly or implicitly, to attempt to resolve their disputes without resort to what one judge has called the "draconian" remedy of judicial dissolution.

Judicial dissolution proceedings also can be costly, distracting, and stressful and can have unintended consequences for the parties. Nonetheless, the statutory right to make a claim for dissolution remains and a party's assertion of the right may actually result in an order of dissolution given the right set of facts. Such a claim may also lead to a quicker or more favorable settlement of the underlying conflicts than the parties otherwise may have reached.

Therefore, parties involved in a business divorce situation should at least consider the viability of a claim for judicial dissolution when reviewing their negotiation and litigation options.

### A. Judicial Dissolution of Corporations

Massachusetts General Laws Chapter 156D, § 14.30 provides the statutory grounds for judicial dissolution and provides, in relevant part:

> The superior court . . . may dissolve a corporation: . . .
>
> (2) upon a petition filed by the shareholders holding not less than 40 per cent of the total combined voting power of all the shares of the corporation's stock outstanding and entitled to vote on the question of dissolution, if it is established that:
>
> (i) the directors are deadlocked in the management of the corporate affairs, the shareholders are unable to break the deadlock, and irreparable injury to the corporation is threatened or being suffered; or
>
> (ii) the shareholders are deadlocked in voting power and have failed, for a period that includes at least 2 consecutive annual meeting dates, to elect successors to directors whose terms have expired, or would have expired upon the election of their successors, and irreparable injury to the corporation is threatened or being suffered; . . . .

As noted in the Comments to the Introduction to Chapter 156D, this statute "is based on, but is not identical to, the American Bar Association's Model Business Corporation Act. The Model Act is the basis for the corporate statutes of a substantial majority of the states, including all the other New England states."

There are no reported Massachusetts appellate decisions concerning Section 14.30. Of the three reported Superior (trial) Court decisions, none of the courts in those cases entered final orders allowing the requests for judicial dissolution. Each of these cases provides useful guidance for parties involved in judicial dissolution proceedings, however.

***Rowley Auto Parts, Inc. v. Bontos, 2009 Mass. L. Rep. 607 (Mass. Super. Ct. 2009).*** The two shareholders were brothers who each owned 50% of the company's shares and were the two directors of a company whose primary asset was land. The brothers agreed that the property should be sold, but disagreed as to the method of sale, the listing price, the land's value for listing purposes, the distribution of sale proceeds and other details surrounding the sale. The petitioning brother asserted that these disputes constituted director deadlock that the shareholders could not break. The petitioner further argued that the corporation was facing irreparable injury because the land was a wasting asset. The responding brother disputed the existence of deadlock and disputed that the company would suffer irreparable injury.

In ruling on the petitioner's summary judgment motion, the Court noted that "this significant discord can constitute director deadlock." The Court also concluded that the shareholders "have, so far, been unable to break the deadlock." The Court nonetheless determined that the responding brother's affidavit and other materials in response to the petitioning brother's summary judgment papers "creates material issues of fact as to whether

there is a deadlock within the meaning of . . . § 14.30." In making this general statement, the Court did not reference any particular fact that the responding brother's papers put in material dispute. Instead, the Court simply noted that it "is not entitled to lightly conclude that there is a deadlock for purposes of a petition to dissolve the Corporation." For its Order, the court scheduled the case "for the earliest available trial" and simultaneously referred the case to mediation. According to the online docket sheet for this case, the matter was reported settled by the parties and dismissed within three months of the Court's decision denying the request for judicial dissolution.

***Kerkorian v. Northworks Properties, Inc., 25 Mass. L. Rep. 155 (Mass. Super. Ct. 2009).*** The two shareholders each owned 50% of the company's shares and were the sole directors of the company, which owned, leased and managed a building containing 24 condominium units. In 2008, the company lost numerous tenants and saw its rent revenue decline substantially from its rent revenue in 2006. Kerkorian filed a petition for judicial dissolution and sought the appointment of a receiver for the sale and wind-down of the company. Kerkorian argued that the loss of tenants was causing a loss of the building's value, which in turn was causing the corporation to lose value. As such, he wanted the building to be sold and claimed that the management of the company was deadlocked on that point. In response, Marini, the other shareholder, argued that the business operated at a profit and that no deadlock existed in the management of the business.

The Court stated that it appeared "clear that the shareholders are 'deadlocked' on the issue of whether the corporation should be dissolved and its assets . . . sold." However, the Court noted further that the statute requires that there be deadlock in the <u>management</u> of the corporation. On that point, the Court found that Kerkorian continued to be the manager of the company and that the company continued to make a profit despite the present downturn in the real estate market. From these facts, the Court determined that Kerkorian had not proven either that there was deadlock in the company's management or that the company was threatened with irreparable harm. The Court therefore denied the motion for appointment of a receiver. The online docket sheet for this case shows that, within six months of the Court's order denying the motion, the case was dismissed by the Court due to the parties' failures to continue to prosecute or defend the matter.

In a footnote within the decision, the Court noted that each party had raised the other's alleged improper motives related to the potential sale of the property. Mariani alleged that Kerkorian was seeking to sell the property because he needed funds to satisfy divorce orders and not because of any claimed harm to the company. For his part, Kerkorian claimed that Mariani was refusing to sell the property because his current tax position would be negatively impacted by such a sale. The Court did not find the alleged motivations to be relevant to the issues before it.

***Constantine v. Lawnicki, 22 Mass. L. Rep. 745 (Mass. Super. Ct. 2007).*** The two shareholders each owned 50% of the company's shares and were the sole directors of the company, which operated a small vending machine service and maintenance company. One of the shareholders brought a petition for judicial dissolution and thereafter moved for summary judgment. The Court did not describe in detail the precise dispute between the shareholders, but stated only that the issues "may, on their face, seem minor." Nonetheless, the Court noted,

"given the two-man nature of the company and its business there clearly appears to be a deadlock with the directors in the management of the corporate affairs, which the shareholders, being the same persons as the directors, are unable to break." The Court also determined that, given the small size of the company and the nature of its business, there needs to be almost total unanimity in the management to avoid irreparable harm. Finally, the Court determined that "the entity cannot long survive under the present situation" and therefore faces irreparable injury.

The Court noted that, given the foregoing, it was "relatively comfortable that a dissolution of [the company] for deadlock pursuant to [Section] 14.30(2) may well be warranted." Nonetheless, the Court still apparently was reluctant to issue an immediate order of dissolution. Specifically, the Court referred to the Comment to Section 14.30, which provides in part, that "the availability . . . of dissolution to a disgruntled shareholder is rarely desirable, normally has material adverse effects on other constituencies . . . , and normally leads in the end to a buy-out and not dissolution even after dissolution is entered." Thus, "in deference . . . to the interpretive Comment," the Court deferred any final determination for one month from the date of its written decision "to give the parties still further time to attempt a less draconian resolution."

In a footnote within the decision, the Court indicated that it was aware that, before the date of its decision, the parties already had made significant, but unsuccessful, efforts to settle their disputes. The Court nonetheless noted that "there is, however, not much to fight over and the costs of litigation will rapidly out-reach the corporation's worth." The online docket sheet reflects that after the Court issued its decision, the parties filed various motions for extensions of time and then reported the case settled without any order of dissolution ever entering.

### B. Judicial Dissolution of Limited Liability Companies and Limited Partnerships

Massachusetts General Laws Chapter 156C, § 44 governs judicial dissolution of LLCs and provides:

> On application by or for a member or manager the superior court department of the trial court may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on its business in conformity with the certificate of organization or the operating agreement.

According to the Historical and Statutory Notes to Chapter 156C, § 1, "[t]his chapter is similar to §§ 101 to 1206 of the Uniform Limited Liability Company Act."

Massachusetts General Laws Chapter 109, § 45 governs judicial dissolution of limited partnerships and provides:

> On application by or for a partner the superior court department of the trial court may decree dissolution of a limited partnership whenever it is not reasonably practicable to carry on the business in conformity with the partnership agreement.

According to the Historical and Statutory Notes, "[t]his section is similar to § 802 of the Revised Uniform Limited Partnership Act."

As with the statute providing for judicial dissolution of Massachusetts corporations, the Massachusetts LLC and limited partnership statutes have not been the subject of many reported decisions. Those few courts that have dealt with the statute have reached mixed results, but, again, indicate a tendency not to order the requested dissolution except in the most clear-cut case of deadlock and inability to carry on the business as intended through the formation documents.

***In re Symes/Nigro Litig., 27 Mass. L. Rep. 279 (Mass. Super. Ct. 2010).*** Two individual parties and their respective business entities (three limited partnerships and an LLC) jointly owned commercial property. Symes filed complaints to dissolve all the entities and argued that the partners had reached a deadlock regarding the management of the property such that it was not reasonably practicable to carry on the business of the limited partnerships in accordance with their partnership agreements, nor to carry on the business of the LLC in accordance with the certificate of organization.

Nigro moved for summary judgment on the grounds that Symes had breached the partnership agreements through his application to the Court for dissolution of the partnerships. Nigro argued that judicial dissolution was impermissible because the agreements provided that the partnerships would continue for a specific term of years and therefore the only methods by which the partnerships could be dissolved were those set forth in the agreements. Nigro further argued that, as a result of Symes' alleged breaches, control of the partnerships passed to Nigro under the terms of the agreements. The Court rejected Nigro's argument and determined that nothing in the language of the agreements indicated that the specified events were intended to be the exclusive triggers for dissolution or that the partners intended to waive their right to seek dissolution by court decree under Massachusetts law. "In short, nothing in the statutes, the case law, or the language of the partnership agreements forecloses the [plaintiff] from seeking judicial dissolution prior to expiration of the partnerships by their terms."

In interpreting the agreements in this case, the Court cited to cases from other jurisdictions for the proposition that parties may relinquish their right to judicial dissolution through specific and unequivocal language in an agreement expressing their intention to do so. From a drafting perspective, then, if desired, it is important to include such a clear and specific waiver clause in the relevant agreement at the outset, since courts are unlikely to read such a waiver into agreements otherwise.

***Scotland Drive, LLC v. Tosi, 22 Mass. L. Rep. 231 (Mass. Super. Ct. 2007).*** In this case, the Court was "faced, once again, with the unhappy and contentious difficulties that involve the second and third generations in, and benefitting from, a family enterprise apparently almost wholly created by the hard work of the family patriarch who, with his wife, delegated the enterprise to his two daughters." The daughters became the two general partners of two limited partnerships that owned and operated a "small real estate empire" in Boston. The parents, the daughters, and the daughters' children were limited partners of the partnerships. A rift developed between the daughters over the management of the partnerships. It is unclear from the decision what exactly the dispute entailed. However, the Court noted, but did not rely upon, the suggestion in the record that one of the daughters had become "estranged and distant" from the rest of the family.

One of the daughters filed a motion for appointment of a receiver in connection with an underlying claim for dissolution of the partnerships. The Court initially stated that mere discontent of some limited partners with the actions of a general partner does not provide proof of the inability to carry on the business in conformity with the partnership agreements. Nor is such disagreement sufficient to warrant the Court's use of the "extraordinary" power of dissolution. The Court did note that where the dispute was between the only two general partners, "[t]his presents a more serious situation." On the preliminary record, the Court denied the motion, citing to the discretionary nature of the relief. The Court also noted that it was "aware that a forced dissolution of a limited partnership may produce serious and unintended adverse consequences for the various partners."

Finally, the Court noted that it expected that through further proceedings, the parties would likely develop a fuller record from which the Court could determine whether dissolution was appropriate. In doing so, however, the Court issued a word of caution to the parties' lawyers in a footnote: "The attorneys on both sides are urged to take off their hats as advocates and put on something more befitting counselors in an effort to patch up, fairly to all, this unfortunate family squabble." According to the online docket sheet, the case was later reported settled and was dismissed.

***Rapoza v. Talamo, 2006 Mass. Super. LEXIS 531 (Mass. Super. Ct. Oct. 10, 2006).*** The two parties were each 50% members and the sole two managers of two LLCs, through which they practiced ophthalmology. Rapoza filed an emergency motion to appoint a liquidating agent. Before doing so, the two members had already agreed upon the division of the patient end of the practice. However, the Court noted, "it is the economic and business end of the separation that has spurred some tasteless haggling, resulting in the request for injunctive relief." Nonetheless, the Court determined that given the prior split of the patient relationships and the decision to formally separate the two doctors' practices (albeit as yet not implemented), dissolution of the LLCs was warranted as "there is a clear and total deadlock between the sole two managers and members thereof." The Court ruled further that "it clearly is not reasonably practicable to carry on the business in conformity with the presumed certificates of organization." The Court then ordered that a liquidating trustee be appointed to carry out the winding up of the LLC's affairs.

According to the online docket sheet for this case, the Court appointed a liquidating trustee within a couple of weeks of its decision. However, the parties continued to litigate their claims, with defendant pursuing a discovery-related motion and plaintiff filing a motion to disqualify defendant's counsel. Both these motions were denied, but these further proceedings suggest that even an order of judicial dissolution does not necessarily end the disputes between the parties.

Further, the liquidating trustee filed her certificate of completion over a year and a half after being appointed by the Court. In the interim, the trustee filed a motion to approve the fees and costs incurred by the trustee and her professionals, which was allowed. It is unclear what the amount of these fees and costs was, but these fees were almost certainly paid from the liquidation proceeds before a distribution, if any, was made to the members on account of their membership interests.

## Conclusion

A company's owners have a statutory right to seek judicial dissolution. However, at least in Massachusetts, courts have rarely found that parties seeking such relief have met their burden of establishing management and shareholder deadlock and irreparable harm, in the case of a corporation, or that it was not reasonably practicable to carry on the company's business, in the case of an LLC or a limited partnership. Further, when faced with such claims, courts have generally strongly encouraged, if not ordered, the parties to negotiate a private resolution to their dispute short of dissolution. Even if parties were to litigate a dissolution proceeding to a final order, they should expect to incur substantial expense, which could be disproportionately high relative to the value of their ownership interests. Further, such proceedings, standing alone, may not resolve all disputes between the parties. In the end, the parties should consider, as a court likely will, whether there exists a "less draconian resolution" than judicial dissolution.