JUDICIAL DISSOLUTION UNDER NEW YORK'S LIMITED LIABILITY COMPANY LAW: SHOULD BREAKING UP BE THIS HARD TO DO?

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INTRODUCTION

The mid-1970s brought hope to America: the wars were over; the economy was starting to improve; the first wave of baby boomers were celebrating their thirtieth birthdays; and, in Wyoming, the American limited liability company (LLC) was born.[1] Although variations on the LLC form were already popular in Europe, South America, and Japan, this type of entity was virtually unheard of in the United States—an entrepreneur formed either a corporation, partnership, or limited partnership.[2] LLCs offered the best of all worlds: limited liability, partnership taxation, and the flexibility of a customizable operating agreement.[3]

States were initially apprehensive about LLCs—without a firm declaration from the IRS about tax implications, many legislatures did not give the entity much consideration.[4] However, in 1988, after the IRS issued Revenue Ruling 88-76, declaring that LLCs would be classified as partnerships for tax purposes, statute enactment spread like wildfire.[5] Recognizing the possibility of losing new business to states with LLC laws,[6] states rushed to get their own laws on the books—by the end of 1993, more than twenty-five states had LLC laws and by December 1996, every state and the District of Columbia was in the LLC business.[7]

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1 WYO. STAT. ANN. §§ 17-15-101 to -136 (1977) (repealed 2010).

2 LLCs have existed in Europe, South America, and Japan since the late 1800s. *See* 1 NICHOLAS G. KARAMBELAS, LIMITED LIABILITY COMPANIES: LAW, PRACTICE AND FORMS § 6:2 (2d ed. Supp. 2016).

3 One commentator has noted that the rise of the LLC in the 1990s allowed Generation X to "have it all—partnership tax, limited liability, and default rules more suited to the small business than are the corporate default rules." Howard M. Friedman, *The Silent LLC Revolution—The Social Cost of Academic Neglect*, 38 CREIGHTON L. REV. 35, 42 (2004).

4 Between 1977 and 1988, only Wyoming and Florida had LLC statutes. *See* Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L.J. 1459, 1463–69 (1998).

5 Rev. Rul. 88-76, 1988-2 C.B. 360. Between 1977 and 1990, only Wyoming, Florida, Colorado, and Kansas had LLC statutes. In 1991, Texas, Utah, Virginia, and Nevada enacted statutes; the total number of LLC statutes in the United States was at eight. Between 1992 and 1996, the remaining forty-two states and the District of Columbia enacted LLC legislation. *See* Hamill, *supra* note 4, at 1469–79.

6 *See* Carol R. Goforth, *The Rise of the Limited Liability Company: Evidence of a Race Between the States, but Heading Where?*, 45 SYRACUSE L. REV. 1193, 1199 (1995) (providing a comprehensive overview of early state LLC enactment).

7 Hamill, *supra* note 4, at 1475–78.

The explosion of LLC formation was unprecedented—by 2007, the number of new LLCs doubled that of corporations.[8] Today, the LLC is the most prevalent form of new business organization in the United States.[9]

Described as a hybrid entity, an LLC operating agreement—a central component of the LLC form—draws on characteristics of both partnership agreements and corporate bylaws.[10] Based on principles of freedom of contract, the operating agreement allows parties to determine the management, policies, procedures, and fate of the enterprise.[11] In the event of a dispute, the operating agreement is the first point of reference.[12] Should a lawsuit ensue, a court will apply common-law contract principles to interpret the operating agreement.[13]

Unfortunately, for some co-venturers, the hallmark flexibility of LLCs has proven too much to handle, resulting in the messiest of business divorces.[14] Similar to when two people get married, individuals entering into a business venture are not inclined to plan fully for the possibility of an eventual separation or divorce.[15] As such, parties often skip over providing exit-mechanisms or tie-breaking provisions in the operating agreement.[16] This omission increases the likelihood that a member will find himself dissatisfied, and possibly stuck, at some point in the future. Furthermore, while touted as a "plus" of the LLC form, many state LLC laws do not provide any statutory withdrawal rights or exit-mechanisms similar to those found in corporation and partnership laws.[17] Absent any planning, LLC members who wish to unilaterally exit

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8 Rodney D. Chrisman, *LLCs Are the New King of the Hill: An Empirical Study of the Number of New LLCs, Corporations, and LPs Formed in the United States Between 2004–2007 and How LLCs Were Taxed for Tax Years 2002–2006*, 15 FORDHAM J. CORP. & FIN. L. 459 (2010).

9 KARAMBELAS, *supra* note 2, § 6:2.

10 *See* Joan MacLeod Heminway, *The Ties That Bind: LLC Operating Agreements as Binding Commitments*, 68 SMU L. REV. 811, 824 (2015).

11 *See id.* at 813–15.

12 KARAMBELAS, *supra* note 2, § 6:14.

13 *See* Heminway, *supra* note 10, at 822–23.

14 *See* Friedman, *supra* note 3, at 55 ("The flexibility of LLCs also is the source of one of their disadvantages. LLC statutes are sometimes not comprehensive in creating default rules. More often than in corporate statutes, they fail to anticipate some of the gaps that may occur in poorly drafted governing documents.").

15 Robert B. Thompson, *Allocating the Roles for Contracts and Judges in the Closely Held Firm*, 33 W. NEW ENG. L. REV. 369, 375 (2011) [hereinafter Thompson, *Allocating the Roles*].

16 Robert B. Thompson, *Corporate Dissolution and Shareholders' Reasonable Expectations*, 66 WASH. U. L.Q. 193, 224 (1988) [hereinafter Thompson, *Corporate Dissolution*] ("[D]isputes that lead to petitions for dissolution do not easily lend themselves to advance planning. Parties entering into a business relationship are not always willing to fully explore the ramifications of possible disputes if things were to go wrong. A prolonged focus on the 'downside' may seem inconsistent with the mutual trust on which the business must depend.").

17 *See infra* notes 50, 51, 62 and accompanying text.

an LLC are likely to face an unduly difficult predicament, sometimes requiring court intervention.[18]

New York courts now face an increased number of petitions for judicial dissolution where formerly amicable LLC co-venturers have failed to provide for exit-mechanisms in the operating agreement.[19] To compound the issue, the judicial dissolution provision of New York's Limited Liability Company Law (New York's LLC Law) provides courts little direction to decide a petition; specifically, a court may order dissolution if it is "not reasonably practicable" to continue the LLC in conformity with its operating agreement.[20] Without a final word from the New York Court of Appeals, every trial court and appellate decision interpreting the "not reasonably practicable" standard is valuable for future practitioners and judges tasked with arguing and adjudicating contentious LLC judicial dissolution petitions under New York's LLC Law.

In 2010, the Second Department of the New York Appellate Division interpreted the "not reasonably practicable" standard when it decided *In re 1545 Ocean Avenue, L.L.C.*[21] (*1545 Ocean Avenue*). The court in *1545 Ocean Avenue* defined carrying on the business of an LLC "not reasonably practicable" when either (1) the LLC does not meet its stated purpose; or (2) continuing the LLC is financially unfeasible.[22] While this "seminal" case[23] appeared to give meaning to the vague statutory language, the ultimate effect of this standard promotes functioning businesses over functioning personal relationships—an illogical result in the context of closely-held entities.[24] Recognizing the futility of these outcomes, but refusing to accept deadlock as a reason for judicial dissolution, New York courts are now jumping through hoops to apply the unwieldy standard.

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18 *See* Thompson, *Corporate Dissolution*, *supra* note 16, at 224.

19 *See* Peter A. Mahler, *When Limited Liability Companies Seek Judicial Dissolution, Will the Statute Be up to the Task?*, N.Y. ST. B.J., June 2002, at 8, 13.

20 N.Y. LTD. LIAB. CO. LAW § 702 (McKinney 2016).

> On application by or for a member, the supreme court in the judicial district in which the office of the limited liability company is located may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement. A certified copy of the order of dissolution shall be filed by the applicant with the department of state within thirty days of its issuance.

Id.

21 *In re* 1545 Ocean Ave., L.L.C., 893 N.Y.S.2d 590 (App. Div. 2010).

22 *Id.* at 597–98.

23 Peter Mahler, *Finding Purpose Outside the LLC Agreement*, FARRELL FRITZ: N.Y. BUS. DIVORCE (June 8, 2015), http://www.nybusinessdivorce.com/2015/06/articles/grounds-for-dissolution/finding-purpose-outside-the-llc-agreement.

24 *See* discussion *infra* note 38.

This Note addresses the issues that arise when member relations in New York LLCs become irreconcilably fractious and require judicial intervention. Because New York's LLC Law does not provide exit-rights, parties who wish to sever relations with other members must either draft an operating agreement that provides for withdrawal or expulsion, negotiate an exit-right under hostile conditions, or persuade a court to order the remedy in the context of a judicial dissolution action.[25] Under current New York case law, disagreement—deadlock—between LLC members is not an independent ground for judicial dissolution.[26] Rather, the petitioner must convince the court that the LLC is unable to practicably achieve its purpose or is financially unfeasible.[27] The New York standard, which rejects the application of corporate and partnership principles to LLCs,[28] gives extreme deference to the operating agreement and is more stringent than the same standard in Delaware, whose Limited Liability Company Act (Delaware LLC Act) is, like New York's LLC Law, also grounded on principles of freedom of contract.[29] Faced with an increasing number of petitions for judicial dissolution due to irreconcilable deadlock between LLC members, New York judges are finding creative ways to circumvent the current standard in order to grant dissolution.

This Note argues that New York should replace its current, flawed approach with a standard similar to that of Delaware, which permits deadlock as a ground for judicial dissolution. Under the Delaware standard, New York courts could order judicial dissolution when the relations between the parties have become so hostile that continuing to work together is futile. The Delaware standard, which can aptly be described as "deadlock-plus," is desirable because it does not give judges unfettered freedom to order judicial dissolution. Rather, under the "deadlock-plus" standard the parties must show deadlock *plus* the non-existence of an enforceable and adequate exit-mechanism within the four corners of the operating agreement, or, if an acceptable exit-mechanism is indeed provided for in the operating agreement, the continuation of the LLC is financially unfeasible.[30] Ultimately, the "deadlock-plus" standard, as evidenced by Delaware case law, preserves

25 *See* Mahler, *supra* note 19, at 16.

26 *See In re 1545 Ocean Ave., L.L.C.*, 893 N.Y.S.2d at 598.

27 *Id.* at 597–98.

28 *Id.* at 595 ("Limited liability companies thus fall within the ambit of neither the Business Corporation Law nor the Partnership Law.").

29 DEL. CODE ANN. tit. 6, § 18-802 (West 2011); Haley v. Talcott, 864 A.2d 86, 96 (Del. Ch. 2004).

30 *See infra* Section II.C.

principles of freedom of contract while promoting functioning business relationships.

Part I of this Note provides general background information about corporations, general and limited partnerships, and LLCs. Part II examines the hodgepodge of legislation pertaining to LLC dissolutions and discusses the corresponding case law, showing how the Second Department's interpretation of "not reasonably practicable" has failed to provide a workable standard for judicial dissolution. This Part also explains how Delaware's interpretation of the judicial dissolution standard provides guidance as to when it is appropriate for the judiciary to intervene after relations become irreconcilably hostile. Finally, Part III proposes that New York adopt the "deadlock-plus" standard, the same approach promulgated in Delaware.

I. BACKGROUND

A. *Corporations*

Corporations[31] are distinct legal persons that exist independently of shareholders.[32] As legal persons, most for-profit corporations are subject to corporate income taxes.[33] Known as "double taxation," a shareholder who receives dividends from the corporation is also taxed on that income.[34] The advantages of corporations include limited personal liability for corporate debts and torts as well as the benefit of perpetual existence; events such as death or withdrawal of an individual shareholder or manager do not cause the corporation to dissolve or terminate.[35]

Modern corporation codes are predominantly tailored to meet the needs of large, publicly traded corporations in which the shareholders'

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31 In this Note, "corporations" refers to "C" corporations. "C" corporations are typical, taxable corporations that limit investors' liability. "S" corporations (not discussed in this Note) are corporations that are not subject to double taxation, but have other restrictions that make them unsuitable for large corporations. *See* Park McGinty, *The Limited Liability Company: Opportunity for Selective Securities Law Deregulation*, 64 U. CIN. L. REV. 369, 376 (1996).

32 In 1819, the U.S. Supreme Court defined a corporation as "an artificial being, invisible, intangible, and existing only in contemplation of law." *See* Trs. of Dartmouth Coll. v. Woodward, 17 U.S. 518, 636 (1819).

33 H.R. 3321, 63d Cong., 38 Stat. 114 (1913). In 1913, Congress further humanized corporations by declaring: "the normal [income] tax . . . imposed upon individuals likewise shall be levied . . . to every corporation . . . ." *Id.* Corporations are also able to take and hold property, sue and be sued, make contracts, and act through officers and agents. 1 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 5 (Supp. 2016).

34 Goforth, *supra* note 6, at 1284.

35 FLETCHER, *supra* note 33, § 6.

principal role is to elect a board to manage the entity's affairs—ownership and control of the corporation are separate.[36] While some flexibility in corporate structure and management is allowed, corporation statutes contain a number of mandatory rules that cannot be contracted away.[37] These mandatory rules proved unworkable in the context of closely-held corporations in which ownership and control of the corporation are vested in a few individuals whose shares are illiquid.[38] In light of possible minority oppression, closely-held corporation law developed what is known as a "shareholders' agreement" to govern the relations between the parties—these agreements are often enforced by courts.[39]

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36 *See* Harwell Wells, *The Rise of the Close Corporation and the Making of Corporation Law*, 5 BERKELEY BUS. L.J. 263, 265–66 (2008) ("The statutes seemed to work well for large corporations, as the corporate structure mandated in statute—with an active Board of Directors overseeing the corporation's affairs and shareholders playing little role in governance beyond electing those directors—mirrored the way most large corporations actually operated.").

37 *See* Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1553 (1989) ("[C]orporate law, as it stands today, has not fully embraced the model of unrestrained opting out. Much of corporate law is certainly flexible, in the sense that the parties can opt out of many statutory default[s] . . . . Nevertheless, many features of corporate law, great and small, are mandatory."). To the contrary, it is worth noting that the Delaware General Corporation Law is popular for its "broad[ly] enabling" characteristics and contains few mandatory requirements. *See* Williams v. Geier, 671 A.2d 1368, 1381 (Del. 1996).

38 Thompson, *Corporate Dissolution*, *supra* note 16, at 196. Closely-held corporations are usually comprised of a small number of participants who manage and provide capital to the business. *Id.* These individuals generally invest both monetary and human capital in the business, play a predominate role in management, and expect more (i.e., employment) from the business than a shareholder would in a publicly traded entity. *Id.* Further, there is no market for shares of a closely-held corporation. *Id.* It follows that if a shareholder of a closely-held corporation wants to get out of the business, he must negotiate a deal with the other shareholders or seek judicial dissolution.

39 *See* Wells, *supra* note 36, at 297–304. Prior to shareholders' agreements, contractual governance and dispute resolution agreements were within the domain of the general partnership—if parties wanted to be managed by agreement, they needed to be co-partners, not co-shareholders, in the business. While initially reluctant to enforce shareholders' agreements, courts across the United States became increasingly amenable to enforcing the agreements as a common law of private corporations developed. *See id.* at 293–95. Examples of provisions that were contained in early shareholders' agreements include: (1) agreements to vote for one another as directors; (2) director agreements to appoint one another as officers; (3) agreements to pay officers certain salaries; (4) agreements to have a third party manage the company; and (5) buy/sell agreements that would apply when a shareholder wished to exit the business. *Id.* at 297–98. At first, close corporation law was very unpredictable—parties did not know whether the court would invalidate or uphold the shareholders' agreements. *Id.* at 98. Today, many states formally permit "close corporations" (qualifying non-public corporations) to be governed by a shareholders' agreement. As close corporation law continued to develop notwithstanding the lack of statutory authority, some state legislatures attempted to standardize close corporation law by enacting regulatory schemes specifically oriented to close corporations. *Id.* at 311–14. These statutes, enacted in fewer than half of the states, are unpopular for a number of reasons with the main reason simply being that shareholders are content with the deference courts give to shareholders' agreements, rendering statutes unnecessary and possibly restrictive. *Id.* at 314–15.

To resolve serious shareholder disputes, all state corporation laws provide the statutory remedy of judicial dissolution.[40] Most jurisdictions permit courts to judicially dissolve corporations in the event the shareholders or management are deadlocked.[41] In deadlock situations, some states' statutes provide, as an alternative to dissolution, that the remaining shareholders may buy out the petitioner for fair value.[42] Furthermore, most state statutes provide for judicial dissolution where those in control of the corporation engage in misconduct.[43] States often provide enhanced protections for minority shareholders of closely-held corporations to petition for judicial dissolution in light of the lasting impact of deadlock and minority oppression compounded with the illiquidity of shares.[44] Often, a successful showing of minority oppression[45] in a closely-held corporation triggers a statutory buyout

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40 *See* Thompson, *Corporate Dissolution*, *supra* note 16, at 199; *see, e.g.*, ARIZ. REV. STAT. ANN. § 10-1430(B) (2013); CAL. CORP. CODE § 1800 (West 2014); FLA. STAT. ANN. § 607.1430(2) (West 2016); 805 ILL. COMP. STAT. ANN. 5/12.55 (West 2010); MICH. COMP. LAWS ANN. § 450.1489 (West 2016); N.J. STAT. ANN. § 14A:12-7 (West 2003); N.Y. BUS. CORP. LAW § 1104 (McKinney 2003); N.C. GEN. STAT. ANN. § 55-14-30(2) (West 2011); OR. REV. STAT. ANN § 60.661 (West 2003); WASH. REV. CODE ANN. § 23B.14.300(2) (West 2013); *see also, e.g.*, MODEL BUS. CORP. ACT. § 14.30(a)(2) (AM. BAR. ASS'N 1984) (providing a model set of business corporation laws promulgated by the Committee on Corporate Laws of the Section of Business Law of the American Bar Association).

41 *See* Susanna M. Kim, *The Provisional Director Remedy for Corporate Deadlock: A Proposed Model Statute*, 60 WASH. & LEE L. REV. 111, 113–14 (2003). Deadlock can occur for two reasons: (1) the shareholders are divided and cannot elect directors, or (2) the directors are divided so the board cannot take any effective management action. *Id.* at 119–20. While deadlock indeed applies in public corporations, deadlock issues most commonly arise in the context of closely-held corporations where the corporation is comprised of two fifty percent shareholders and majority consent is required to take any action. *See id.* at 120. Deadlock may also arise when shares of the corporation are split among three shareholders and those shareholders are unable to reach a majority decision. *Id.* Delaware, Kansas, and Oklahoma only permit dissolution on deadlock in joint venture corporations with two fifty percent shareholders; Nevada does not explicitly mention deadlock in its corporation laws, but has broad grounds by which a shareholder can otherwise seek judicial dissolution. Thompson, *Corporate Dissolution*, *supra* note 16, at 201 n.34 and accompanying text.

42 *See* Kim, *supra* note 41, at 113–14 (noting that the purpose of a buyout remedy is to preserve the business).

43 *See* Thompson, *Corporate Dissolution*, *supra* note 16, at 205–11. State statutes often provide that shareholders may petition for dissolution of a corporation on the grounds of fraud, illegality, or misapplication of assets. *Id.* at 205.

44 *See id.* at 197–99 (noting that the legislation and judicial decisions providing alternative relief for closely-held corporations benefit minority shareholders because investors tend to fail to plan for a falling out or failure of the business, increasing the risk that minority shareholders will be caught in a deadlock and/or oppressed by the majority without any means to liquidate their shares).

45 *See id.* at 205–10. The definition of "oppression" varies among states and generally falls into one of three categories: (1) "burdensome, harsh and wrongful conduct"; (2) majority breaches of fiduciary duty of good faith and fair dealing; or, most popular, (3) a frustration of the reasonable expectations of the shareholders. *Id.* at 208. New York follows the third definition of oppression and considers the "reasonable expectations" of the complaining

option.[46] Because corporations are distinct entities presumed to have perpetual existence, judicial dissolution of a corporation, also known as "judicially imposed death,"[47] is considered by many states to be an extreme remedy.[48] State dissolution statutes typically do not mandate the court to order dissolution—even if the requisite standard is met—but rather provide the court discretion to determine whether dissolution is appropriate.[49]

Like most states, New York's Business Corporation Law provides shareholders two alternative grounds to petition for judicial dissolution. Shareholders holding fifty percent or more of the votes may seek dissolution in the event of a deadlock,[50] or shareholders of closely-held corporations holding at least twenty percent of the votes may seek dissolution if those in control are acting oppressively towards minority

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shareholder. *See In re* Kemp & Beatley, Inc., 473 N.E.2d 1173, 1179 (N.Y. 1984) (adopting the "reasonable expectations" standard).

46 *See* Thompson, *Allocating the Roles*, *supra* note 15, at 399; *see also, e.g.*, N.Y. BUS. CORP. LAW § 1118(a) (McKinney 2003) ("[A]ny other shareholder or shareholders or the corporation may, at any time within ninety days after the filing of such petition or at such later time as the court in its discretion may allow, elect to purchase the shares owned by the petitioners at their fair value and upon such terms and conditions as may be approved by the court.").

47 *In re* Radom & Neidorff, Inc., 119 N.E.2d 563, 565 (N.Y. 1954) ("The prime inquiry is, always, as to necessity for dissolution, that is, whether judicially[-]imposed death 'will be beneficial to the stockholders or members and not injurious to the public.'" (citation omitted)).

48 *See* Thompson, *Corporate Dissolution*, *supra* note 16, at 195, 204; *see also* Brenner v. Berkowitz, 634 A.2d 1019, 1033 (N.J. 1993) (noting that dissolution should be reserved for the "most egregious cases").

49 Thompson, *Corporate Dissolution*, *supra* note 16, at 203–06. For example, dissolution petitions are rarely granted when a shareholder has the means to dispose of his shares, as in a public corporation. *See* 3 JAMES D. COX & THOMAS LEE HAZEN, TREATISE ON THE LAW OF CORPORATIONS § 14:13 (3d ed. 2015 & Supp. 2016). Whether the continued profitability of a corporation is grounds for judicial dissolution varies among the states. *See* Thompson, *Corporate Dissolution*, *supra* note 16, at 203–04; *see, e.g.*, BUS. CORP. § 1111(b)(3) ("[D]issolution is not to be denied merely because it is found that the corporate business has been or could be conducted at a profit.").

50 The provision for judicial dissolution of a corporation (public or non-public) on the grounds of deadlock provides:

> (a) Except as otherwise provided in the certificate of incorporation under section 613 (Limitations on right to vote), the holders of shares representing one-half of the votes of all outstanding shares of a corporation entitled to vote in an election of directors may present a petition for dissolution on one or more of the following grounds:
>
> > (1) That the directors are so divided respecting the management of the corporation's affairs that the votes required for action by the board cannot be obtained.
> > (2) That the shareholders are so divided that the votes required for the election of directors cannot be obtained.
> > (3) That there is internal dissension and two or more factions of shareholders are so divided that dissolution would be beneficial to the shareholders.

BUS. CORP. § 1104(a).

shareholders or misappropriating corporate assets.[51] While shareholders of public corporations may only avail themselves of judicial dissolution in the event of deadlock, shareholders of closely-held corporations who meet the standing requirements may petition under either (or both) judicial dissolution provisions of the Business Corporation Law.[52] Additionally, if a petitioner of a closely-held corporation successfully shows oppression or misappropriation, the Business Corporation Law provides that the respondent may buy out the petitioner's shares as a way to avoid dissolution.[53]

B. *General Partnerships*

A general partnership arises, with or without a written agreement, when two or more people carry on a business and intend to share profits and managerial control.[54] One drawback of a general partnership is that partners are vicariously and personally liable for the torts, debts, and

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51 The judicial dissolution provision for non-public corporations provides:

> (a) The holders of shares representing twenty percent or more of the votes of all outstanding shares of a corporation, other than a corporation registered as an investment company under an act of congress entitled "Investment Company Act of 1940", no shares of which are listed on a national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national or an affiliated securities association, entitled to vote in an election of directors may present a petition of dissolution on one or more of the following grounds:
>
> > (1) The directors or those in control of the corporation have been guilty of illegal, fraudulent or oppressive actions toward the complaining shareholders;
> > (2) The property or assets of the corporation are being looted, wasted, or diverted for non-corporate purposes by its directors, officers or those in control of the corporation.
>
> (b) The court, in determining whether to proceed with involuntary dissolution pursuant to this section, shall take into account:
>
> > (1) Whether liquidation of the corporation is the only feasible means whereby the petitioners may reasonably expect to obtain a fair return on their investment; and
> > (2) Whether liquidation of the corporation is reasonably necessary for the protection of the rights and interests of any substantial number of shareholders or of the petitioners.

BUS. CORP. § 1104-a (footnote omitted). Section 1104-a was added in 1979 to provide statutory protection for minority shareholders in closely-held corporations. *See* Glen Banks, *The Unresolved Tension Between the 1979 Amendments to the BCL and Shareholder Agreements in Close Corporations*, N.Y. ST. B.J., Feb. 1995, at 16, 16.

52 *See In re* Kournianos, 571 N.Y.S.2d 823 (App. Div. 1991).

53 *See* Thompson, *Allocating the Roles*, *supra* note 15, at 387.

54 UNIF. P'SHIP ACT § 102(11) (UNIF. LAW COMM'N 2013) (defining a partnership as "an association of two or more persons to carry on as co-owners a business for profit"). Except Louisiana, every state and the District of Columbia has adopted either the 1914 or 1997 version of the Uniform Partnership Act. COX & HAZEN, *supra* note 49, § 1:7(2) n.13.

obligations of the partnership.[55] Although stuck with unlimited personal liability, the upside of a general partnership is that partners are free to govern the firm without any statutory constraints and enjoy pass-through taxation.[56]

The rationale behind the freedom conferred on partnerships is that the risk of personal liability will motivate individuals to structure partnerships as fair and law-abiding entities.[57] Though not required, agreements between partners, known as partnership agreements, are crucial to a successful partnership.[58] Drawing on principles of freedom of contract, parties may negotiate desired terms of a partnership agreement including profit allocation, events upon which the partnership will or will not dissolve, distributions upon winding up of affairs, and other matters, so long as fundamental contract principles are not violated.[59] Partnership agreements may be express, oral, or implied, and state partnership statutes are made up almost entirely of default rules that only govern when the partnership agreement is silent.[60]

Today, the majority of state partnership statutes provide for a presumption of perpetual existence—the exit of any partner does not automatically dissolve the firm.[61] New York, however, still follows the original rule: dissolution occurs upon the exit of any partner, for any reason, unless otherwise provided in the partnership agreement.[62] Upon withdrawal, a partner is entitled to receive the liquidation value of his share[63] and, should the remaining partners continue the business, the

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55 *See, e.g.*, REVISED UNIF. P'SHIP ACT § 306 (UNIF. LAW COMM'N 1997).

56 McGinty, *supra* note 31, at 376 ("[General partnerships] are treated as pass-through entities, thereby sparing investors from being taxed twice on the partnership's profits.").

57 *See* 1 KARON S. WALKER, NEW YORK LIMITED LIABILITY COMPANIES AND PARTNERSHIPS: A GUIDE TO LAW AND PRACTICE § 6:4 (Supp. 2016).

58 15A N.Y. JUR. 2D *Business Relationships* § 1558 (Supp. 2017).

59 *See* Prince v. O'Brien, 650 N.Y.S.2d 157 (App. Div. 1996) (holding that an oral partnership agreement creates a partnership at will); *see also* Lanier v. Bowdoin, 24 N.E.2d 732, 735 (N.Y. 1939) (stating that unless prohibited by statute or common law, "the partners of either a general or limited partnership . . . may include in the partnership articles any agreement they wish concerning the sharing of profits and losses, priorities of distribution on winding up . . . and other matters," and noting further that "[i]f complete, as between the partners, the agreement so made controls").

60 UNIF. P'SHIP ACT § 102(12) (UNIF. LAW COMM'N 2013).

61 Larry E. Ribstein, *The Evolving Partnership*, 26 J. CORP. L. 819, 847–50 (2001) (discussing that the default rule under the Uniform Partnership Act provides that each partner can dissolve the partnership at will, while the default rule under the Revised Uniform Partnership Act enacted in most states eliminates this default rule).

62 N.Y. P'SHIP LAW § 62 (McKinney 2015). In New York, partnerships are automatically dissolved at any time a partner dissociates from the partnership, with or without violation of the partnership agreement. *Id.* Other grounds for dissolution include bankruptcy, death, and judicial order. *Id.*

63 *Id.* § 74 ("The right to an account of his interest shall accrue to any partner, or his legal representative, as against the winding up partners or the surviving partners or the person or

partnership becomes a partnership at will.[64] Due to the ease of withdrawal and dissolution under New York's Partnership Laws, petitions for judicial dissolution generally arise in situations where the partners are deadlocked and cannot agree on a course of action, yet do not wish to voluntarily cause dissolution.[65]

C. *Limited Partnerships*

Prior to the enactment of limited partnership statutes, an individual who invested and shared in the profits of an unincorporated business was a general partner by law and, therefore, liable for the debts and obligations of the partnership.[66] The potential cost of personal liability discouraged investors, forcing "ill-suited" partnerships to incorporate to shield investors from personal liability.[67] Limited partnership statutes were the initial amalgam of corporation and partnership law, allowing partnerships to raise capital without subjecting the investors (limited partners) to potential personal liability.[68]

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partnership continuing the business, at the date of dissolution, in the absence of agreement to the contrary.").

64 *See* Bitetto v. F. Chau & Assocs., L.L.P., 807 N.Y.S.2d 260 (Sup. Ct. 2005) (noting that a partnership at will is created if the remaining partners continue the business).

65 In *Krulwich v. Posner*, 738 N.Y.S.2d 315 (App. Div. 2002), the supreme court granted dissolution of the general partnership under subsections (c), (d), and (e) of New York's Partnership Law. On appeal, the First Department modified the order, holding that the general partnership was dissolved under subsection (f) "by reason of the irreconcilable dissension between the two equal partners." *Id.* at 302. The judicial dissolution provision under New York's Partnership Law provides:

> The court shall decree a dissolution.
>
> 1. On application by or for a partner whenever:
>
> > (a) A partner has been declared incompetent in any judicial proceeding or is shown to be of unsound mind,
> > (b) A partner becomes in any other way incapable of performing his part of the partnership contract,
> > (c) A partner has been guilty of such conduct as tends to affect prejudicially the carrying on of the business,
> > (d) A partner wilfully [sic] or persistently commits a breach of the partnership agreement, or otherwise so conducts himself in matters relating to the partnership business that it is not reasonably practicable to carry on the business in partnership with him,
> > (e) The business of the partnership can only be carried on at a loss,
> > (f) Other circumstances render a dissolution equitable . . . .

P'SHIP § 63.

66 UNIF. LTD. P'SHIP ACT official cmt. (UNIF. LAW COMM'N 1916).

67 *Id.*

68 COX & HAZEN, *supra* note 49, § 1:9.

In addition to enjoying pass-through tax treatment,[69] limited partnerships share a vital characteristic with general partnerships—governance by a partnership agreement, which gives partners broad power to define the relations, activities, duration, management, and termination of the partnership.[70] Limited partnerships initially did not have a presumption of perpetual existence; if a general partner no longer associated with the partnership (whether by bankruptcy, death, incompetency, or voluntary/involuntary withdrawal), the partnership was automatically dissolved.[71] Today, many states—not including New York[72]—have amended their statutes to provide limited partnerships the presumption of perpetual existence.[73] Under statutes that presume perpetual existence, the withdrawal of a general partner, as long as there is at least one remaining general partner, does not cause automatic dissolution.[74]

Under New York's Revised Limited Partnership Act (NYRLPA), a general partner's withdrawal triggers automatic dissolution,[75] unless the partnership agreement permits the business to be carried on by the remaining general partner (if there is only one left), or the remaining limited partners (in the event there are no general partners left) agree to continue the limited partnership and appoint a new general partner.[76] Subject to the partnership agreement, a withdrawing general partner is entitled to be paid the fair value of his share within a reasonable amount of time.[77] Without the presumption of perpetual existence, general partners are afforded liberal exit rights under the NYRLPA and

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69 *See* David Rosenberg, *Venture Capital Limited Partnerships: A Study in Freedom of Contract*, 2002 COLUM. BUS. L. REV. 363, 376–77.

70 *See id.* at 378–81. However, unlike partnerships and like corporations, limited partnerships are statutorily created and distinct legal entities that must adhere to specific legal formalities. *See* COX & HAZEN, *supra* note 49, § 1:9.

71 UNIF. LTD. P'SHIP ACT § 801 (UNIF. LAW COMM'N 1985) (non-judicial dissolution); *see also id.* § 402 (events of withdrawal of a general partner). Under this Act, while dissolution is caused by the withdrawal of a general partner, the exit of a limited partner, on the other hand, does not cause automatic dissolution. *Id.* § 801(4).

72 N.Y. P'SHIP LAW §§ 121-402, 121-801 (McKinney 2015) (section 121-402 provides for events of withdrawal of a general partner and section 121-801 provides for non-judicial dissolution).

73 UNIF. LTD. P'SHIP ACT § 801(a)(3)(A) (UNIF. LAW COMM'N 2013).

74 *Id.*

75 P'SHIP § 121-801(d). Of note, under section 121-602, a general partner may withdraw at any time upon written notice to the other partners. However, if withdrawal is in violation of the partnership agreement, the withdrawing partner may be subject to damages for breach of the partnership agreement. *Id.* § 121-602.

76 *Id.* § 121-801. New York's limited partnership laws generally track the language of the Revised Uniform Limited Partnership Act enacted in 1976 (amended in 1985). *See* UNIF. LTD. P'SHIP ACT § 801(4) (UNIF. LAW COMM'N 1985).

77 P'SHIP § 121-604.

presumably have no need to seek judicial dissolution.[78] Limited partners, on the other hand, do not have statutorily defined exit-rights and may not withdraw prior to the dissolution and winding up of the partnership, unless otherwise provided in the partnership agreement.[79] Although limited partners lack statutory exit rights, very few petitions for judicial dissolution have been decided under the NYRLPA.[80] The dearth of judicial dissolution petitions may be attributed to general market principles: if a limited partner wishes to withdraw and the business is worth more than its liquidation value, the general partners are incentivized to negotiate a buyout of the limited partner's shares in lieu of dissolution.[81]

D. *Limited Liability Companies*

The newest and most popular business entity in the United States,[82] LLCs draw from the attractive aspects of corporations, partnerships, and limited partnerships.[83] The LLC form gives members maximum flexibility by integrating the corporate shield of limited liability with the partnership perk of pass-through taxation and broad freedom to construct operating agreements suited to the needs of the owners.[84]

As a hybrid of its corporation and partnership predecessors, LLC statutes naturally borrow language from corporation, general, and

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78 *See* Mahler, *supra* note 19, at 11–12 ("Historically, partnership squeeze-out cases are rare . . . because of the relative ease of exit under partnership law. In the absence of any agreement to the contrary, a partner can dissolve the partnership at any time and receive his or her rightful share of the liquidation proceeds." (footnote omitted)).

79 P'SHIP § 121-603(a) ("Notwithstanding anything to the contrary under applicable law, unless a partnership agreement provides otherwise, a limited partner may not withdraw from a limited partnership prior to the dissolution and winding up of the limited partnership.").

80 Although without explicitly citing the NYRLPA, the only New York case discussing the judicial dissolution of a limited partnership was dismissed after the court found the removed general partner lacked standing to bring a claim for judicial dissolution. *See* Balme v. Satterwhite, 594 N.Y.S.2d 158 (App. Div. 1993); *see also In re* 1545 Ocean Ave., L.L.C., 893 N.Y.S.2d 590, 595 (App. Div. 2010) ("While there are no New York cases which interpret and apply this standard in the context of limited partnerships . . . .").

81 *See* Mahler, *supra* note 19, at 12 ("If the business as a going concern is worth more than its liquidation value, the partners are highly motivated to negotiate a buyout.").

82 *See* Chrisman, *supra* note 8.

83 *See* Elizabeth S. Miller, *Are the Courts Developing a Unique Theory of Limited Liability Companies or Simply Borrowing from Other Forms?*, 42 SUFFOLK U. L. REV. 617, 617–19 (2009).

84 Chrisman, *supra* note 8, at 485 ("[P]ractitioners are beginning to see benefits to the LLC state-law form beyond merely limited liability and partnership taxation that would make them want to use an LLC . . . . For instance, the enormous flexibility and contractual nature of the LLC may provide advantages . . . .").

limited partnership law.[85] The first LLC statute, enacted in 1977 in Wyoming[86] borrowed substantially from corporation law, but also from partnership and limited partnership law.[87] While many states initially modeled LLC laws after Wyoming's corporation-derived statute, other state legislatures recognized that the flexibility of limited partnership laws provided a better model for LLCs.[88] State LLC laws are largely comprised of default rules that can be waived or amended in the operating agreement.[89] If an LLC does not have an operating agreement or the operating agreement is silent on an issue, the state LLC statute governs.[90]

Under former Revenue Ruling 88-76, adopted in 1988, for an LLC to be classified as a partnership for federal income tax purposes, the LLC was required to have no more than two of the following four corporate characteristics: (1) continuity of life (perpetual existence),[91] (2) centralization of management, (3) limited liability, and (4) free transferability of interests.[92] This four-factor test proved unduly complex for practitioners trying to figure out how to structure corporations and partnerships.[93] Rather than burden new LLC owners with the intricacies of the four-factor test, most states drafted statutes

85 Goforth, *supra* note 6, at 1235. While many states initially modeled their LLC laws after Wyoming's corporation-derived statute, some states used limited partnership statutes as a model. *Id.* at 1220–62; *see also* Larry E. Ribstein, *Linking Statutory Forms*, 58 LAW & CONTEMP. PROBS. 187, 213–14 (1995) (providing a table that shows which LLC provisions are borrowed from other business entities).

86 WYO. STAT. ANN. §§ 17-15-101 to -136 (1977) (repealed 2010).

87 *See* William J. Carney, *Limited Liability Companies: Origins and Antecedents*, 66 U. COLO. L. REV. 855, 857 (1995). The 1977 Wyoming LLC statute was comprised of modified versions of twenty-six provisions of the Wyoming Business Corporation Act, at least seven provisions of Wyoming Uniform Limited Partnership Act, and at least three provisions of the Wyoming Uniform Partnership Act. *See id.* at 858.

88 *See* Goforth, *supra* note 6, at 1225.

89 *See* UNIF. LTD. LIAB. CO. ACT § 105 cmt. at 26 (UNIF. LAW COMM'N 2013).

90 *See* Goforth, *supra* note 6, at 1208 n.77.

91 In this Note, "continuity of life" and "perpetual existence" are used interchangeably. In general, "continuity of life" is referred to when discussing the corporate characteristics for the four-factor test prior to Revenue Ruling 88-76. *See, e.g.*, N.Y. LTD. LIAB. CO. LAW Ch. 34 cmt. 8.1 (McKinney 2016). "Perpetual existence" is often used to describe LLCs that will continue to exist notwithstanding the withdrawal of a member. *See, e.g.*, N.Y. LTD. LIAB. CO. LAW § 701(a)(1) (McKinney 2016).

92 Heather M. Field, *Checking in on "Check-the-Box"*, 42 LOY. L.A. L. REV. 451, 460–63 (2009).

93 Steven A. Dean, *Attractive Complexity: Tax Deregulation, the Check-the-Box Election, and the Future of Tax Simplification*, 34 HOFSTRA L. REV. 405, 429 (2005). Though appearing simple in language, the four-factor test proved highly complex as the IRS was inconsistent in its application of the test and often classified entities based on specific facts and subtle distinctions. *Id.* at 431. The IRS's failure to promulgate coherent guidance on the four-factor test not only caused many business owners to seek the advice of costly tax lawyers, but also encouraged businesses to be inefficiently structured for no other reason than to meet the stringent classification requirements. *Id.* at 430–31.

with rules providing LLCs with limited liability and centralization of management—without free transferability of interests and perpetual existence, the LLC was automatically eligible for partnership taxation.[94]

Tasked with integrating the four-factor test into its own limited liability company laws, the New York legislature modeled the original withdrawal and dissolution provisions of New York's LLC Law after those under the NYRLPA.[95] Consequently, LLC members, who were viewed as analogous to general partners under the NYRLPA, were afforded liberal exit rights under New York's LLC Law, and judicial dissolution was effectively a non-issue.[96] It was not until the IRS dropped the four-factor test and the New York legislature subsequently amended the original New York LLC Law in 1999 that judicial dissolution entered the spotlight.[97] Under the amended law, statutory exit rights were eliminated and LLC members were more akin to limited partners under the NYRLPA.[98] However, unlike limited partners, LLC members do not have general partners with whom they can negotiate a buyout.[99] In other words, unless provided for in the operating agreement, LLC members under the amended law have no statutory exit rights.

Section II.A discusses how the New York legislature's amendments to New York's LLC Law (1999 Amendments) effectively eliminated

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94 Field, *supra* note 92, at 462.

95 *Compare* Act of July 26, 1994, ch. 576, §§ 606, 701, 1994 N.Y. Sess. Laws 7511 (McKinney) (codified as amended LTD. LIAB. CO. §§ 606, 701), *with* Act of Dec. 31, 1990, ch. 950, §§ 121-603, -801, 1990 N.Y. Sess. Laws 8542 (McKinney) (codified as amended N.Y. P'SHIP LAW §§ 121-603, -801 (McKinney 2015)). The language of section 606 (withdrawal of a member) of the 1994 New York LLC Act mirrors that of section 121-603 (withdrawal of a limited partner) of the 1990 NYRLPA. *Compare* § 606, *with* § 121-603. Under these provisions, limited partners and LLC members may withdraw according to the agreement or upon six months' prior written notice, unless otherwise provided by agreement. § 606; § 121-603. However, under section 701 of the 1994 New York LLC Law, the withdrawal of a member automatically triggers dissolution, whereas under section 121-801 of the NYRLPA, only the withdrawal of a *general* partner, and not a limited partner, automatically triggers dissolution. *Compare* § 701, *with* § 121-801. As such, the New York legislature borrowed withdrawal language from the NYRLPA provision governing *limited* partners, yet for purposes of dissolution, analogized LLC members to *general* partners under the NYRLPA, thereby conforming to the four-factor test by creating automatic dissolution upon withdrawal of a member. The ultimate effect of selectively analogizing LLC members to both limited and general partners greatly reduced the need for judicial dissolution as members could easily dissolve the entity by withdrawal.

96 See *supra* note 95 and *infra* Sections II.B and II.C for a discussion about the ease of exit rights for general partners under New York's partnership and limited partnership laws. *See also supra* note 78 and accompanying text.

97 Prior to the enactment of the 1999 amendments, only one case concerning the judicial dissolution standard was decided in New York, by the Fourth Department. *See In re* Roller, 689 N.Y.S.2d 897 (App. Div. 1999) (mem.).

98 *See supra* note 79 and accompanying text.

99 *See supra* note 81 and accompanying text.

statutory exit rights. Section II.B examines the Second Department's decision in *1545 Ocean Avenue* in which the "not reasonably practicable" standard was defined, followed by an assessment of the implications this standard had on two subsequent decisions, *Natanel v. Cohen*[100] and *Mizrahi v. Cohen*.[101] Finally, Section II.C analyzes how Delaware courts have interpreted and applied the same "not reasonably practicable" provision when deciding judicial dissolution petitions under Delaware law.

II. ANALYSIS

By the time New York enacted its limited liability company law in 1994, at least thirty-five other states already had limited liability company statutes.[102] The New York legislature anticipated that the new laws would attract business to the state by providing an attractive alternative to partnerships and corporations.[103] In particular, the legislature opined that these laws would benefit real estate businesses, small businesses, joint ventures, high-tech businesses, and venture capital firms.[104]

While the legislative history of New York's LLC Law is fairly sparse, it is clear that the New York legislature opted to borrow much of the language for the limited liability company law from corporation and partnership law.[105] Unsurprisingly, because corporations and partnerships are inherently different entities, provisions of New York's LLC Law do not always work well together.[106] In addition to provisions not aligning, some parts of the law seem to omit certain topics entirely.[107] The resulting effects of the 1999 Amendments to New York's LLC Law accurately reflect some of these issues.

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100 Natanel v. Cohen, No. 502760/13, 2014 WL 1671557, at *1 (N.Y. Sup. Ct. Apr. 18, 2014).

101 Mizrahi v. Cohen, 961 N.Y.S.2d 538 (App. Div. 2013). Note: there is no relation between the two Cohens.

102 S. 217-27F, 1994 Sess., at 7 (N.Y. 1994).

103 *Id.*

104 *Id.*

105 Meredith R. Miller, *The New York Limited Liability Company Law at Twenty: Past, Present & Future*, 31 TOURO L. REV. 403, 403–04 (2015).

106 *Id.* at 404.

107 *Id.* (referring to the case of *Tzolis v. Wolff*, 884 N.E.2d 1005 (N.Y. 2008), where the New York Court of Appeals addressed whether an LLC member could bring a derivative suit and New York's LLC Law did not have any provisions at all addressing the topic).

A. *The 1999 Amendments and the Elimination of Statutory Exit Rights*

Three years after New York enacted its limited liability company law, the IRS replaced the four-factor corporate characteristic test with the "check-the-box" regulations.[108] The check-the-box regulations automatically classify newly created unincorporated entities (including LLCs) as partnerships for federal income tax purposes, unless an election is made otherwise.[109] Without the four-factor test, LLC laws could provide a presumption of perpetual existence in addition to limited liability and centralization of management.[110] Following the lead of many other states, New York's amended withdrawal and dissolution provisions went into effect in 1999.[111]

Under the post-1999 Amendments to New York's LLC Law, the dissolution section provides for the corporate characteristic of perpetual existence: an LLC will *not* dissolve unless the operating agreement provides for dissolution by a certain date or upon the happening of specified events, consented to by a majority vote, or judicially dissolved.[112] Deciding LLCs should be treated similarly to corporations,[113] the New York legislature also amended the withdrawal provisions of New York's LLC Law by eliminating the right to unilaterally withdraw prior to dissolution and winding up.[114] The

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108 *See* Field, *supra* note 92, at 463–70; *see also* Treas. Reg. § 301.7701-2 (1996); T.D. 8697, 1997-1 C.B. 215.

109 Mahler, *supra* note 19, at 10.

110 *See* Field, *supra* note 92, at 482–83.

111 The amended dissolution provision of New York's Limited Liability Company Laws states:

> (b) Unless otherwise provided in the operating agreement, the death, retirement, resignation, expulsion, bankruptcy or dissolution of any member or the occurrence of any other event that terminates the continued membership of any member *shall not* cause the limited liability company to be dissolved or its affairs to be wound up, and upon the occurrence of any such event, the limited liability company *shall be continued without dissolution*, unless within one hundred eighty days following the occurrence of such event, a majority in interest of all of the remaining members of the limited liability company or, if there is more than one class or group of members, then by a majority in interest of all the remaining members of each class or group of members, vote or agree in writing to dissolve the limited liability company.

N.Y. LTD. LIAB. CO. LAW § 701(b) (McKinney 2016) (emphasis added).

112 *Id.*

113 N.Y. Bill Jacket, 1999 S.B. 1640, ch. 420, 222d Leg. Reg. Sess. (1999) [hereinafter Bill Jacket] ("A shareholder of a corporation does not have a right of withdrawal or redemption absent an express agreement. It is appropriate to treat limited liability companies/partnerships similarly to corporations in this area.").

114 The withdrawal provision of New York's LLC Law post-1999 Amendments (including today) reads:

legislature reasoned that because member withdrawals are capable of severely impacting small-business operations, the statute should avoid providing withdrawal rights that could give rise to potentially adverse consequences.[115]

While the 1999 Amendments appear to liberate LLCs from the confines of corporation and partnership restrictions, the ultimate effect of these amendments is the elimination of statutory exit rights available to disgruntled LLC members who can no longer unilaterally exit the firm and receive fair value.[116] In circumstances where the parties are irreconcilably hostile and the LLC operating agreement does not provide for an alternative exit mechanism, judicial dissolution—a provision that has gone unchanged since the initial enactment of New York's LLC Law—appears to be the only way out.[117]

Under the judicial dissolution provision of New York's LLC Law, the petitioner must show it is "not reasonably practicable" to carry on the LLC in conformity with its operating agreement.[118] This standard is

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> (a) A member may withdraw as a member of a limited liability company only at the time or upon the happening of events specified in the operating agreement and in accordance with the operating agreement. Notwithstanding anything to the contrary under applicable law, unless an operating agreement provides otherwise, a member may not withdraw from a limited liability company prior to the dissolution and winding up of the limited liability company. Notwithstanding anything to the contrary under applicable law, an operating agreement may provide that a membership interest may not be assigned prior to the dissolution and winding up of the limited liability company.

LTD. LIAB. CO. § 606(a).

115 Bill Jacket, *supra* note 113 ("The exercise of withdrawal rights may seriously affect the operations of small business, and by providing such rights as a default rule, the existing statute may have unanticipated adverse consequences.").

116 *See* Mahler, *supra* note 19, at 10, 12.

117 *In re* 1545 Ocean Ave., L.L.C., 893 N.Y.S.2d 590, 594 (App. Div. 2010). The adverse ramifications of the revised provisions are best exemplified in an LLC with two fifty percent shareholders (*A* and *B*) who have a falling out: under a plain reading of amended section 606(a), *A* may not withdraw and receive the fair value of his membership unless the LLC is dissolved, and under amended section 701, the LLC cannot be dissolved without consent of the majority—in this case both *A* and *B*. Accordingly, if *B* refuses to dissolve the LLC, *A* cannot unilaterally cause dissolution and is left only with the statutory remedy of judicial dissolution under section 702. This example assumes that the LLC either has no operating agreement or is otherwise silent or inadequate with regard to withdrawal and voluntary dissolution rights.

118 The judicial dissolution provision of New York's LLC Law provides:

> On application by or for a member, the supreme court in the judicial district in which the office of the limited liability company is located may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement. A certified copy of the order of dissolution shall be filed by the applicant with the department of state within thirty days of its issuance.

LTD. LIAB. CO. § 702.

copied from the NYRLPA.[119] Practically speaking, however, the absence of a statutory definition as well as the lack of limited partnership case law interpreting judicial dissolutions left open the question of what it means to be "not reasonably practicable" for an LLC to carry on in conformity with its operating agreement.[120] Faced with an increasing number of petitions for judicial dissolution, New York courts initially avoided defining the "not reasonably practicable" standard.[121]

Finally, in 2010, the Second Department addressed the standard as an issue of first impression when it decided *1545 Ocean Avenue*.[122]

B. 1545 Ocean Avenue *and the "Not Reasonably Practicable" Standard*

In *1545 Ocean Avenue*, Van Houten and King were each fifty percent members of Ocean Suffolk, a New York LLC formed to purchase property at 1545 Ocean Avenue, rehabilitate the existing building, and construct a new building on the property for commercial rental.[123] Without the consent and against the wishes of King, Van Houten Construction (VHC), owned by Van Houten, began demolition and reconstruction of the existing building.[124] As VHC continued to work on the site, relations between King and Van Houten became increasingly tense and King eventually announced his intention to withdraw his investment in the LLC.[125] Deadlocked and unable to agree upon an adequate buyout proposal, King filed a petition for judicial dissolution.[126]

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119 The judicial dissolution provision of the NYRLPA provides:

> On application by or for a partner, the supreme court in the judicial district in which the office of the limited partnership is located may decree dissolution of a limited partnership whenever it is not reasonably practicable to carry on the business in conformity with the partnership agreement. A certified copy of the order of dissolution shall be filed by the applicant with the department of state within thirty days of its issuance.

N.Y. P'SHIP LAW § 121-802 (McKinney 2015).

120 *In re 1545 Ocean Ave., L.L.C.*, 893 N.Y.S.2d at 595–96 ("[T]here are no New York cases which interpret and apply this [not reasonably practicable] standard in the context of limited partnerships . . . .").

121 *Id.* at 594 (citing cases that avoided interpreting the "not reasonably practicable" standard: *In re Extreme Wireless, L.L.C.*, 750 N.Y.S.2d 520 (App. Div. 2002); *Horning v. Horning Constr., L.L.C.*, 816 N.Y.S.2d 877, 881–83 (Sup. Ct. 2006); and *Spires v. Casterline*, 778 N.Y.S.2d 259 (Sup. Ct. 2004)).

122 *Id.* at 594–95.

123 *Id.* at 592.

124 *Id.*

125 *Id.* at 593.

126 *Id.* at 593–94.

On appeal, the Second Department determined that even though the parties were deadlocked, the purpose of the LLC—to develop the property at 1545 Ocean Avenue—was being met and, therefore, King could not force judicial dissolution to extract himself from the LLC.[127] The court reasoned that because the operating agreement expressly permitted one party to act unilaterally on behalf of the LLC and was silent as to manager disagreements, there was no basis for judicial dissolution.[128] The court concluded that for a court to order judicial dissolution, the petitioner must establish either: (1) that the management of the LLC is unwilling or unable to promote the stated purpose of the business, or (2) that continuing the entity is financially unfeasible.[129]

1545 Ocean Avenue heightened the standard for judicial dissolution of New York LLCs compared to other business entities.[130] In its reading of the judicial dissolution provision of New York's LLC Law, the Second Department rejected judicial dissolution in the event of disagreement between two fifty percent shareholders.[131] The court found that because "deadlock" is not expressly provided for, as it is under New York's corporation laws, it would be inappropriate to import this ground for dissolution into the limited liability company law.[132] To determine whether judicial dissolution is warranted, the *1545 Ocean Avenue* court explained, is initially a contract-based analysis which requires examination of the operating agreement to determine whether the stated purpose of the LLC is being met.[133]

To support its interpretation of the "not reasonably practicable standard," the *1545 Ocean Avenue* court quoted decisions from other

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127 *Id.* at 596–97.

128 *Id.* at 597.

129 *Id.* at 598.

> After careful examination of the various factors considered in applying the "not reasonably practicable" standard, we hold that for dissolution of a limited liability company pursuant to [New York's LLC Law §] 702, the petitioning member must establish, in the context of the terms of the operating agreement or articles of incorporation, that (1) the management of the entity is unable or unwilling to reasonably permit or promote the stated purpose of the entity to be realized or achieved, or (2) continuing the entity is financially unfeasible.

Id. at 597–98. While the court did not reach the merits of what it means to be "financially unfeasible," it noted that merely showing the LLC did not experience a "smooth glide to profitability" was insufficient for judicial dissolution. *Id.* (quoting *In re* Arrow Inv. Advisors, L.L.C., No. 4091-VCS, 2009 WL 1101682, at *2 (Del. Ch. Apr. 23, 2009)).

130 *See supra* Sections I.A–C regarding the judicial dissolution standards in other business entities.

131 *In re 1545 Ocean Ave., L.L.C.*, 893 N.Y.S.2d at 596.

132 *Id.*

133 *Id.* at 596–97.

jurisdictions holding judicial dissolution available when the purpose of the LLC was not being met.[134] While the cases cited by the *1545 Ocean Avenue* court indeed provide language in support of its holding, it would appear upon closer look of the cited opinions that all of those courts acknowledged deadlock as an acceptable ground for LLC judicial dissolution.[135]

The *1545 Ocean Avenue* decision was a turning point for New York limited liability companies.[136] On the one hand, the court finally made a definitive statement about the "not reasonably practicable" standard—undefined for over sixteen years.[137] Additionally, the holding in *1545 Ocean Avenue* aligned New York with other jurisdictions by promoting

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134 *Id.* Specifically, the court cited *Schindler v. Niche Media Holdings*, 772 N.Y.S.2d 781 (Sup. Ct. 2003), *abrogated by* Tzolis v. Wolff, 884 N.E.2d 1005 (N.Y. 2008), when it stated: "It has been suggested that judicial dissolution is only available when the petitioning member can show that the limited liability company is unable to function as intended or that it is failing financially." *Id.* at 596. The court later quoted *Dunbar Group, L.L.C. v. Tignor*, 593 S.E.2d 216 (Va. 2004), when it said: "In Virginia, dissolution is only available when the business cannot continue 'in accord with its . . . operating agreement.'" *Id.* at 596–97 (alteration in original). Finally, to support its finding on the "not reasonably practicable" standard, the court cited *Kirksey v. Grohmann*, 2008 S.D. 76, 754 N.W.2d 825, when it stated: "However, where the economic purpose of the limited liability company is not met, dissolution is appropriate." *Id.* at 597.

135 *See id.* at 596–97. Specifically, in denying the petition for judicial dissolution, the court in *Schindler* found that the petitioner had not shown deadlock: "Schindler has nowhere so much as alleged that Niche is unable to carry on its business in accordance with its articles of organization or operating agreement, or that there is any internal 'deadlock' impeding its smooth operation." *Schindler*, 772 N.Y.S.2d at 785. Next, discussing judicial dissolution, the court in *Kirksey* found that the parties' deadlock was grounds for dissolution:

> Moreover, their deadlock certainly impedes the continued function of the business in conformity with its operating agreement. . . . As long as the company remains in control of, and favorable only to, half its members, it cannot be said to be reasonably practicable for it to continue in accord with its operating agreement.

Kirksey, 2008 S.D. 76, ¶ 27. Further, the *1545 Ocean Avenue* court cited *In re Arrow Investment Advisors, L.L.C.*, No. 4091-VCS, 2009 WL 1101682 (Del. Ch. Apr. 23, 2009); however, the *In re Arrow Investment Advisors, L.L.C.* court explicitly found "dissolution is reserved for situations in which the LLC's management has become so dysfunctional or its business purpose so thwarted that it is no longer practicable to operate the business, such as in the case of a voting deadlock." *Id.* at *2. Each of these cases cited by the *1545 Ocean Avenue* court in support of its interpretation of the "not reasonably practicable" standard ultimately found deadlock as an appropriate ground for dissolution. *See id.*; *Schindler*, 772 N.Y.S.2d at 785; *Kirksey*, 2008 S.D. 76, ¶ 27.

136 *See* Peter Mahler, *The Emerging Influence of* 1545 Ocean Avenue *on Judicial Dissolution of LLCs*, FARRELL FRITZ: N.Y. BUS. DIVORCE (Feb. 7, 2011), http://www.nybusinessdivorce.com/2011/02/articles/llcs/the-emerging-influence-of-1545-ocean-avenue-on-judicial-dissolution-of-llcs.

137 Peter Mahler, *It Only Took 16 Years: New York Appellate Court Defines Standard for Judicial Dissolution of Limited Liability Companies*, FARRELL FRITZ: N.Y. BUS. DIVORCE (Feb. 8, 2010), http://www.nybusinessdivorce.com/2010/02/articles/llcs/it-only-took-16-years-new-york-appellate-court-defines-standard-for-judicial-dissolution-of-limited-liability-companies/index.html [hereinafter Mahler, *It Only Took 16 Years*].

principles of freedom of contract by way of deference to the operating agreement.[138] However, rejecting deadlock as a viable ground for judicial dissolution effectively made the New York judicial dissolution standard more stringent than the same standard in other states.[139] The New York standard, by refusing to grant dissolution on the basis of deadlock, implicitly elevates the original business objectives of the LLC over the ongoing functionality of the relationship between the LLC owners.[140] The logic of providing dissolution to deadlocked parties is that equal owners with conflicting personal views should not be forced to be in business.

The following cases expose the major flaws the decision in *1545 Ocean Avenue* had on other New York LLC judicial dissolution cases.

1. No Operating Agreement: *Natanel v. Cohen*

In *Natanel v. Cohen* (*Natanel*), judicial dissolution was sought because the parties, Natanel and Cohen, two fifty percent shareholders of Y and Y, L.L.C. (Y and Y), were irreconcilably deadlocked.[141] Natanel and Cohen formed Y and Y to purchase a building where they each operated their respective businesses.[142] While the venture proved successful for a number of years, the relationship began to deteriorate, resulting in frequent fights.[143] Eventually, both parties relocated their businesses and, after an unsuccessful attempt to negotiate a buyout, Natanel sought dissolution.[144] However, unlike the LLC in *1545 Ocean Avenue*, Y and Y did not have a written operating agreement and was therefore governed by the default rules under New York's LLC Law.[145] Citing *1545 Ocean Avenue*, the *Natanel* court rejected the petitioner's argument that the LLC should be dissolved because the parties were deadlocked.[146] Finding the LLC could not be dissolved due to any financial unfeasibility, the court viewed the issue before it as whether Y and Y was able to function according to its stated purpose, the first

138 Section 1101(b) of the Delaware LLC Act provides: "It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements." DEL. CODE ANN. tit. 6, § 18-1101(b) (West 2011).

139 *See* Mahler, *It Only Took 16 Years*, *supra* note 137.

140 *See* Peter Mahler, *Deadlock Hits Dead End in LLC Dissolution Case*, FARRELL FRITZ: N.Y. BUS. DIVORCE (Aug. 10, 2015), http://www.nybusinessdivorce.com/2015/08/articles/grounds-for-dissolution/deadlock-hits-dead-end-in-llc-dissolution-case.

141 Natanel v. Cohen, No. 502760/13, 2014 WL 1671557, at *1 (N.Y. Sup. Ct. Apr. 18, 2014).

142 *Id.*

143 *Id.* ("On one occasion the police were called.").

144 *Id.*

145 *Id.*

146 *Id.* at *4.

prong under *1545 Ocean Avenue*.[147] However, without a written operating agreement, Y and Y did not have an expressly stated purpose.[148] To determine the purpose of Y and Y, the court decided that the testimony of the parties would be dispositive.[149] After a battle of he-said-she-said,[150] the court concluded that Y and Y's "purpose" no longer existed and dissolution was appropriate.[151]

As in *1545 Ocean Avenue*, the *Natanel* court elevated the original goals of the business over the need to resolve the now-inconsistent goals of the owners that ultimately resulted in a business deadlock. The *Natanel* court implied that notwithstanding the members' acrimony, it would not order dissolution if it found the purpose of the LLC was being met and if the LLC was financially feasible and capable of "muddl[ing] along."[152] Under this reasoning, the fate of the LLC ultimately came down to whether Cohen's or Natanel's version of the LLC's (un-memorialized) purpose was more convincing and, had the court instead agreed with Cohen's testimony, the petition would have been denied, thereby forcing ill-suited members to continue running Y and Y together or, in the alternative, come to a mutually satisfactory decision regarding the LLC—unlikely given the prior failed attempt.[153]

One noteworthy distinction between *Natanel* and *1545 Ocean Avenue* is the default requirement under New York's LLC Law that the management decisions of LLCs be decided by a majority vote.[154] The *Natanel* court quickly glossed over the application of this provision, concluding that there was no perceivable deadlock sufficient to make it not reasonably practicable to continue Y and Y.[155] The actual management decision at issue—that the petitioner wanted to terminate

147 *Id.* at *3 ("It has already been determined that Y and Y is not failing financially and its continued operation is not unfeasible. The issue before the Court is, therefore, whether petitioner has established that Y and Y is unable to function so as to achieve its intended purpose.").

148 *Id.* at *1.

149 *Id.* at *3.

150 *Id.* at *2 ("Suzanne [Cohen] testified that Y and Y had been very effectively managed by herself and Naomi, with whom she was in frequent communication. On rebuttal, however, Naomi [Natanel] vigorously refuted this testimony and adamantly declared her refusal to continue functioning as a surrogate for her husband in managing Y and Y.").

151 *Id.* at *5.

152 *Id.* at *4.

153 *Id.* at *1 ("An attempt was made in 2012 to settle their differences through a negotiated buyout, but it was unsuccessful and it has been over a year since petitioner has spoken to respondent.").

154 Section 408(b) of New York's LLC Law provides: "Except as provided in the operating agreement and in accordance with section four hundred nineteen of this article, the managers shall manage the limited liability company by the affirmative vote of a majority of the managers." N.Y. LTD. LIAB. CO. LAW § 408(b) (McKinney 2016).

155 *Natanel*, 2014 WL 1671557, at *2.

Y and Y, liquidate his investment, and dissociate from the respondent—was entirely disregarded by the court. Whereas the *1545 Ocean Avenue* court was able to deny dissolution by holding enforceable the provision affording one member the ability to act unilaterally on behalf of the LLC, this argument was unavailable to the *Natanel* court. Without this argument, yet recognizing that continuation of Y and Y was illogical under the circumstances, the court was forced to find another way to order judicial dissolution.

Due to the lack of an operating agreement, the *Natanel* court was able to exercise some discretion in finding judicial dissolution warranted. Under the *1545 Ocean Avenue* standard, *Natanel*-like discretion cannot be applied where the parties actually have an operating agreement, even if it is ambiguous. This problem played out in *Mizrahi v. Cohen*, discussed next.

2. The Ambiguous Operating Agreement: *Mizrahi v. Cohen*

The case of *Mizrahi v. Cohen* (*Mizrahi*) involved two fifty percent owners of 372-376 Avenue U Realty L.L.C., an LLC formed for the purpose of constructing and operating a mixed-use commercial and residential building.[156] At the request of the agent at the close of title for the property, Mizrahi and Cohen hastily executed a pre-packaged operating agreement supplied to them by the lawyer acting on behalf of both of them.[157] The operating agreement provided that decisions must be made by the affirmative vote of 100% of the members, and, in the event of a deadlock, the matter may be submitted (within ten days) to a third party to resolve the dispute.[158] The operating agreement did not contain any mechanism for a member to unilaterally exit the business.[159]

From 1999 to 2003, Mizrahi and Cohen contributed equal capital to the LLC.[160] In 2003, after Cohen claimed he was financially unable to continue contributing to the LLC, Mizrahi continued to make all the

156 Mizrahi v. Cohen, 961 N.Y.S.2d 538, 540 (App. Div. 2013).

157 *Id.*; *see* Plaintiff's Trial Memorandum at n.2, *Mizrahi*, 961 N.Y.S.2d 538 (No. 3865/10) ("The contract, a boilerplate document generated from the attorney's word-processor, included the name of someone who had no relation to this company, clearly a left-over name from a previously used agreement. Ezra Cohen read the document at a birthday party and signed it 'on top of a car.'").

158 Mizrahi v. Cohen, No. 3865/10, 2012 WL 104775, at *5 (N.Y. Sup. Ct. Jan. 12, 2012) (decision from the lower court).

159 Plaintiff's Trial Memorandum, *supra* note 157 ("The inartfully drafted operating agreement (intended for use by others) failed to include a provision for separation of the 'partners,' who, other than for the dissolution mechanism of [New York's LLC Law], would be joined at the hip for eternity.").

160 *Id.*

necessary payments for construction of the building, which was completed in 2006.[161] Once completed, the LLC operated at a loss from 2006 until 2011 and tensions between Mizrahi and Cohen escalated.[162] Without any contractual obligation to contribute to the LLC beyond his initial investment, Cohen was able to reap the benefits of Mizrahi's sole funding of the LLC.[163] After many disagreements, none of which were submitted to arbitration as per the optional provision in the operating agreement, Mizrahi filed a petition for judicial dissolution as his only means to discontinue working with Cohen.[164]

Although the lower court in *Mizrahi* noted, in dictum, that the "obvious legislative intent" of the judicial dissolution provision is to provide courts the power to terminate dysfunctional or abusive business relationships,[165] the court declined to grant dissolution on the basis of deadlock, adhering to *1545 Ocean Avenue*.[166] The court also declined to grant dissolution under the first prong of *1545 Ocean Avenue*, determining that because the building was constructed and in operation, the stated purpose of the LLC was already met.[167] Ultimately, the trial court found dissolution appropriate because the LLC was financially unfeasible, satisfying the second prong of *1545 Ocean Avenue*.[168] To reach its conclusion, the court heard the trial testimony of the LLC's accountant and inspected the bookkeeping records submitted into evidence.[169]

Mizrahi v. Cohen spanned three years and included a full trial, an accounting, the appointment of a receiver, and two appeals.[170] While the

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161 *Id.*

162 *Mizrahi*, 2012 WL 104775, at *7. The lower court found that Cohen took $230,000 from the LLC without the consent of Mizrahi; Mizrahi claimed Cohen embezzled the money, while Cohen claimed it was a "loan." *Id.* at *3.

163 Mizrahi v. Cohen, 961 N.Y.S.2d 538, 540 (App. Div. 2013) ("[O]ver time, the plaintiff contributed approximately $1.4 million in capital to the company, while the defendant contributed approximately $317,000 in capital to the company.").

164 *Mizrahi*, 2012 WL 104775, at *5. In his petition for judicial dissolution, Mizrahi sought to buy out Cohen's interest in the LLC. *Id.* at *10.

165 *Id.* at *7 ("[T]he obvious legislative intent of [New York's LLC Law] § 702, [is] to provide a mechanism to equitably terminate a business relationship that is disfunctional [sic] or abusive, without the consent of all of the members.").

166 *Id.* at *8.

167 *Id.*

168 *Id.*

169 *Id.* at *7–8.

170 *See* Mizrahi v. Cohen, 992 N.E.2d 421 (N.Y. 2013) (Court of Appeals decision dismissing the motion for leave to appeal); Mizrahi v. Cohen, 961 N.Y.S.2d 538 (App. Div. 2013) (March 2013 Appellate Division order); Mizrahi v. Cohen, No. 3865/2010, 2013 WL 6570862 (Sup. Ct. Oct. 30, 2013) (October 2013 decision where the court declined plaintiff's order to show cause to vacate prior order); Mizrahi v. Cohen, No. 3865/10, 2013 WL 238490 (Sup. Ct. Jan. 13, 2013) (January 2013 post-accounting decision and appointment of a liquidating trustee); *Mizrahi*, 2012 WL 104775 (January 2012 decision).

dispute included other claims, judicial dissolution was the most hotly contested issue of the case.[171] On appeal, the Second Department affirmed the trial court's finding that judicial dissolution was warranted, but reversed the trial court's decision which denied Mizrahi's petition seeking a forced buyout.[172] Invoking equitable jurisdiction, the Second Department held that "in certain circumstances" the remedy of a buyout by the plaintiff is appropriate even though there is no authority to do so under New York's LLC Law.[173] The *Mizrahi* outcome is paradoxical: while deadlock remains unavailable as a ground for judicial dissolution by reason of the lack of statutory authority, an equitable buyout order is possible, even without any statutory authority.[174]

Taken together, *1545 Ocean Avenue* and *Mizrahi* demonstrate that New York courts will strictly apply the express language contained in the operating agreement. This approach echoes the classical model of contract law in which the contract is interpreted with rigorous objectivity.[175] As exemplified in *Mizrahi*, even if the operating agreement contains boilerplate language and is hastily executed, the court is likely to enforce the express terms. Since *Mizrahi*, New York courts have denied judicial dissolution petitions where the actual business of the LLC no longer existed and the members were deadlocked, but the provision in the operating agreement about the LLC's purpose was worded in broad terms.[176] In the event there is no operating agreement, as in *Natanel*, the "purpose" of the LLC becomes a battle of circumstantial evidence.[177] Finally, if the petitioner can make a showing of financial unfeasibility—which, as in *Mizrahi*, requires much more than the absence of a profit—the court may grant dissolution.[178]

In applying a strict, language-based approach to operating agreements, New York courts are adhering to traditional principles of contract law.[179] Modern commentators have noted that it is

171 *See, e.g.*, Post Trial Memorandum, *Mizrahi*, 2013 WL 6570862 (No. 3865/10) (dissolution is a majority of the argument); Plaintiff's Post Trial Memorandum, *Mizrahi*, 2013 WL 6570862 (No. 3865/10) (same).

172 *Mizrahi*, 961 N.Y.S.2d at 542.

173 *Id.*

174 Peter Mahler, *Appellate Court Orders Equitable Buy-Out in LLC Dissolution Case*, FARRELL FRITZ: N.Y. BUS. DIVORCE (Apr. 1, 2013), http://www.nybusinessdivorce.com/2013/04/articles/llcs/mizrahi-2.

175 Melvin Aron Eisenberg, *The Responsive Model of Contract Law*, 36 STAN. L. REV. 1107, 1108 (1984).

176 Peter Mahler, *LLC Agreement's All-Purpose Purpose Clause Defeats Dissolution Petition*, FARRELL FRITZ: N.Y. BUS. DIVORCE (Dec. 28, 2015), http://www.nybusinessdivorce.com/2015/12/articles/grounds-for-dissolution/llc-agreements-all-purpose-purpose-clause-defeats-dissolution-petition.

177 *See supra* note 150 and accompanying text.

178 *See supra* note 129 and accompanying text.

179 Eisenberg, *supra* note 175, at 1108, 1165.

disingenuous to interpret contracts without any consideration of the context or reasonable expectations of the parties.[180] In Delaware, on the other hand, courts have tended to account for the context of the relationship and the reasonable expectations of the parties, applying a more modern approach to contractual interpretation—the application of the Delaware judicial dissolution standard is discussed below.

C. Haley v. Talcott *and the Delaware "Deadlock-Plus" Standard*

The Delaware Limited Liability Company Act was enacted in 1992 and modeled many of its provisions on Delaware's limited partnership law,[181] including the "not reasonably practicable" language for the judicial dissolution provision.[182] Similar to New York's LLC Law, the original Delaware LLC Act initially eliminated the presumption of perpetual existence to conform to the four-factor test,[183] but was

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> Until thirty or forty years ago, contract theory was dominated by the classical school. Central to the teachings of this school was a system of standardized and rigorously objective axioms that seem to have reflected implicit exemplary cases involving anonymous transactions in perfectly competitive markets. The axioms may have been workable in those cases, but they were too rigid to deal with cases involving the nuances of everyday life.

Id. at 1165.

180 *See, e.g.*, Larry A. DiMatteo & Blake D. Morant, *Contract in Context and Contract as Context*, 45 WAKE FOREST L. REV. 549, 551 (2010) ("To interpret contractual terms or decide disputes without consideration of the context that framed the bargain is a disingenuous analysis at best. Any meaningful and judicious review of contractual matters requires the application of contract rules within an analytical framework that includes the context in which contracts are formed.").

181 *See* Goforth, *supra* note 6, at 1234–35.

182 The "not reasonably practicable" standard appears in the Delaware judicial dissolution provisions for both limited partnerships and limited liability companies. *Compare* DEL. CODE ANN. tit. 6, § 17-802 (West 2011) (judicial dissolution of limited partnerships), *with id.* § 18-802 (judicial dissolution of LLCs).

183 H.B. 608, 136th Gen. Assemb., 2d Reg. Sess. (Del. 1992). The original section 18-801 (dissolution) provision provided:

> A limited liability company is dissolved and its affairs shall be wound up upon the first to occur of the following:
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> (1) At the time specified in a limited liability company agreement, or thirty (30) years from the date of the formation of the limited liability company if no such time is set forth in the limited liability company agreement;
>
> (2) Upon the happening of events specified in a limited liability company agreement;
>
> (3) The written consent of all members;
>
> (4) The death, retirement, resignation, expulsion, bankruptcy or dissolution of a member or the occurrence of any other event which terminates the continued membership of a member in the limited liability company unless the business of the limited liability company is continued either by the consent of all the remaining

ultimately amended after the check-the-box regulations were passed.[184] Known as the most permissive LLC statute, the Delaware LLC Act has the fewest mandatory provisions and expressly provides that principles of freedom of contract should be given maximum effect.[185]

In *Haley v. Talcott* (*Haley*), the two parties, Haley and Talcott, equally owned a fifty percent interest in Matt & Greg Real Estate, L.L.C.[186] The Delaware LLC was created to purchase the land upon which the two ran a successful restaurant, the Redfin Grill.[187] Despite the restaurant's success, personal relations between Haley and Talcott deteriorated, resulting in Haley's desire to end the Redfin Grill's lease and sell the property on the market—a proposition opposed by Talcott.[188] The inability for a member to act unilaterally on behalf of the LLC,[189] coupled with the lack of a tie-breaking provision in the operating agreement, left Haley and Talcott in irreconcilable deadlock, to the benefit of Talcott.[190] Dissatisfied with the exit mechanism provided in the operating agreement, Haley filed a petition for judicial dissolution.[191]

Notwithstanding Delaware's commitment to principles of freedom of contract, the *Haley* court ordered dissolution of the LLC rather than

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> members within 90 days following the occurrence of any such event or pursuant to a right to continue stated in the limited liability company agreement; or
>
> (5) The entry of a decree of judicial dissolution under § 18-802 of this title.

Id.

184 S.B. 104, 139th Gen. Assemb., Reg. Sess. (Del. 1997). As of 1997, the amended section 18-801(b) (dissolution) provision provided:

> (b) Unless otherwise provided in a limited liability company agreement, the death, retirement, resignation, expulsion, bankruptcy or dissolution of any member or the occurrence of any other event that terminates the continued membership of any member *shall not cause the limited liability company to be dissolved* or its affairs to be wound up, and upon the occurrence of any such event, the limited liability company shall be continued without dissolution, unless within 90 days following the occurrence of such event, members of the limited liability company or, if there is more than one class or group of members, then each class or group of members, in either case, by members who own more than fifty percent of the then-current percentage or other interest in the profits of the limited liability company owned by all of the members or by the members in each class or group, as appropriate, agree in writing to dissolve the limited liability company.

Id. (emphasis added).

185 Meghan Gruebner, Note, *Delaware's Answer to Management Deadlock in the Limited Liability Company: Judicial Dissolution*, 32 J. CORP. L. 641, 643 (2007).

186 Haley v. Talcott, 864 A.2d 86, 90–91 (Del. Ch. 2004).

187 *Id.*

188 *Id.* at 95.

189 *Id.*

190 *Id.* at 93.

191 *Id.* at 92.

enforce the exit mechanism.[192] The exit mechanism in the operating agreement provided that the departing member could be bought out of his investment at fair market value.[193] The court reasoned that the exit mechanism was inequitable because both Haley and Talcott had personally guaranteed the entire mortgage and, if forced to use the exit mechanism, Haley would have no control over—yet be personally liable for—any future default on the mortgage by the LLC.[194]

In finding judicial dissolution appropriate, the court's conclusion was two-fold: (1) the parties were irreconcilably deadlocked; and (2) in the context of the deadlock, the exit-mechanism was neither required[195] nor provided an adequate remedy.[196] The court noted that, had the exit mechanism provided an adequate remedy, Delaware's deference to principles of freedom of contract would have permitted the court to "allow the contract itself to solve the problem."[197]

As a case of first impression, the *Haley* court chose to use the deadlock provision of the Delaware General Corporation Law as a framework for its analysis.[198] The *Haley* court concluded that under the Delaware General Corporation Law, the requisites for finding deadlock were indisputably met and, if the LLC were a corporation, judicial dissolution would be justified.[199]

After analyzing the facts of *Haley* under the deadlock provision of the Delaware General Corporation Law, the *Haley* court recognized that, in the context of an LLC, deadlock may make continuance of the

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192 *Id.* at 98.

193 *Id.* at 91–92.

> Section 18 of the LLC Agreement provides that upon written notice of election to 'quit' the company, the remaining member may elect, in writing, to purchase the departing member's interest for fair market value. If the remaining member elects to purchase the departing member's interest, the parties may agree on fair value, or have the fair value determined by three arbitrators, one chosen by each member and a third chosen by the first two arbitrators. The departing member pays the reasonable expenses of the three arbitrators. Once a fair price is determined, it may be paid in cash, or over a term if secured by: 1) a note signed by the company and personally by the remaining member; 2) a security agreement; and 3) a recorded UCC lien. Only if the remaining member fails to elect to purchase the departing member's interest is the company to be liquidated.

Id.

194 *Id.* at 97–98.

195 *Id.* at 92.

196 *Id.* at 97.

197 *Id.* at 96.

198 *Id.* at 93–96. Under section 273 of the Delaware General Corporation Law, the court may order dissolution when: (1) the corporation has two fifty percent shareholders; (2) the shareholders are engaged in a joint venture; and (3) they are unable to agree about whether to discontinue the business or dispose of its assets. *Id.* at 94.

199 *Id.* at 94.

entity "not reasonably practicable."[200] As such, notwithstanding the absence of express authority to grant dissolution on the basis of deadlock in the Delaware LLC Act, the court implies that if a deadlock renders it "not reasonably practicable" for an LLC to continue, there is no need for a specific deadlock provision. Further, the court noted that in order for an LLC to function practicably, it must not operate to the exclusive benefit of one party.[201] Of the two evils, the *Haley* court concluded that between forcing perpetually deadlocked owners to continue to work together or ordering judicial dissolution, judicial dissolution was the more equitable option.

Five years after *Haley* was decided, the Delaware Court of Chancery, in *Fisk Ventures, L.L.C. v. Segal* (*Fisk Ventures*),[202] rejected the exit mechanism provided for in the parties' operating agreement in favor of judicial dissolution, concluding that the "four corners" of the LLC agreement did not provide a remedy for the parties' "hopeless deadlock" and that the deadlock met the "not reasonably practicable" standard.[203]

In *Fisk Ventures*, the operating agreement at issue did not have a tie-breaker provision and required agreement between the managers for all business issues.[204] Deadlocked over whether or not to dissolve the firm after relations had become increasingly hostile, Fisk Ventures sought judicial dissolution.[205] In lieu of dissolution, co-manager Segal sought to compel Fisk Ventures to exercise the so-called "Put Right" provision in the operating agreement.[206] The Put Right allowed Fisk Ventures (and only Fisk Ventures) to exit at any time, for any reason, and receive the fair market value of its shares.[207] Although Fisk Ventures had negotiated for the Put Right to be included in the operating agreement, it did not wish to exercise this option.[208] In finding for Fisk Ventures, the court held that the Put Right was not an adequate exit mechanism under the circumstances.[209]

Seemingly expanding the holding in *Haley*, the *Fisk Ventures* court rejected the respondent's argument that a forced sale of the petitioner's shares would both break the deadlock and preserve the value of the

200 *Id.* at 93–94

201 *Id.* at 96.

202 Fisk Ventures, L.L.C. v. Segal, No. 3017-CC, 2009 WL 73957 (Del. Ch. Jan. 13, 2009), *aff'd*, 984 A.2d 124 (Del. 2009).

203 *Id.* at *4–6.

204 *Id.* at *4.

205 *Id.* at *1.

206 *Id.* at *5.

207 *Id.*

208 *Id.*

209 *Id.*

company.[210] While the *Haley* court held that dissolution was necessary because the exit mechanism (also a forced sale), would not "equitably effect the separation of the parties,"[211] there is no evidence that forcing a sale in *Fisk Ventures* would have subjected either party to any downside risk akin to that in the case of Haley and Talcott.[212] Rather than hold that the exit mechanism was not an "adequate remedy," the *Fisk Ventures* court decided that it would not interfere with the petitioner's personal choice to opt for judicial dissolution instead of exercise the exit right provided in the operating agreement.[213] The *Fisk Ventures* decision implies that an enforceable exit mechanism in the event of deadlock must not only be an adequate remedy, but must also be contemplated as a remedy in the event of deadlock.[214]

Post-*Haley* and *Fisk Ventures*, Delaware courts would be expected to consider three factors when deciding a petition for judicial dissolution on the basis of deadlock: (1) whether a deadlock exists; (2) whether the operating agreement adequately provides for resolving the deadlock; and, if not, (3) whether the financial condition of the LLC prevents the business from effectively operating.[215] Under the Delaware standard, appropriately described as "deadlock-plus," deadlock alone is not enough for the court to grant judicial dissolution—instead, the petitioner must make a showing of deadlock *plus* the lack of an adequate exit mechanism or solution within the operating agreement, or, if the court determines there is an adequate exit-mechanism, a showing that continuation of the LLC is financially unfeasible.

In *Haley* and then *Fisk Ventures*, the court did not focus solely on the objectives of the LLC business, but rather considered the functionality of the *parties* in charge of the LLC. By ordering dissolution on the basis of a deadlock between the controlling parties of an LLC, Delaware courts appear to apply a relational-contextual theory of contracts to LLC agreements. Under this theory, the express provisions of a contract are not dispositive;[216] instead, contracts are interpreted by accounting for the context of the contract as well as the reasonable expectations of the parties.[217] Evidence of Delaware's use of this

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210 *Id.* at *6.

211 Haley v. Talcott, 864 A.2d 86, 98 (Del. Ch. 2004).

212 *Fisk Ventures*, 2009 WL 73957, at *6.

213 *Id.* at *5.

214 *See id.*

215 *Id.* at *4.

216 *See* Larry A. DiMatteo, *Policing Limited Liability Companies Under Contract Law*, 46 AM. BUS. L.J. 279, 308 (2009).

217 *Id.* at 300 ("[The] context [perspective]—the particular characteristics and relationship of the parties to that contract when interpreting the written terms. The relational perspective sees

nuanced theory of contract law appears in *Haley* in two instances. First, the court noted that in a different context such as a voluntary exit, or a "friendly-departure," the highly detailed exit mechanism would be workable.[218] Second, the *Haley* court recognized that the operating agreement provided that no member may act on behalf of the LLC without majority consent—it was not in the parties' reasonable expectations that one member would be a passive investor.[219] By accounting for the context and reasonable expectations of the parties, the approach of Delaware courts is able to give maximum effect to the contract while also considering the relationship between the controlling members—starkly different than the approach of New York courts.[220]

III. PROPOSAL

By rejecting deadlock as an independent ground for judicial dissolution, New York courts are protecting the parties' original business plan at the cost of protecting the business people who own and often operate the business. The current New York standard for judicial dissolution is flawed for a variety of reasons—at worst, it is inefficient, unpredictable, impractical, and often disingenuous. Rather than finding dissolution warranted in cases where there is an undisputed deadlock, New York courts are forced to jump through artificial hoops to find dissolution under the *1545 Ocean Avenue* standard, or, as in *Mizrahi*, to invoke broad equitable discretion to fashion alternative remedies where no statutory authority exists. While both the New York and Delaware standards are premised on freedom of contract, the New York standard applies traditional, if not outdated, contract principles and does not adequately account for the context or reasonable expectations of the parties. Delaware's standard, in contrast, recognizes that deadlocked parties destroy the "reasonable practicability" of continuing the LLC and does not defeat principles of freedom of contract. New York should follow the lead of Delaware and adopt deadlock as a ground for the judicial dissolution of an LLC. As long as New York's LLC Law does not provide a statutory exit remedy, petitions for judicial dissolution

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the contract not just as the express terms of the operating agreement, but also as an agreement based upon the reasonable expectations of the parties.").

218 Haley v. Talcott, 864 A.2d 86, 98 (Del. Ch. 2004).

219 *Id.* at 95.

220 DiMatteo, *supra* note 216, at 300 ("[T]he operating agreement begins a long-term, relational contract. The alignment of interests found at the time of the initial contract formation may be unaligned later in the relationship. Modern contract law provides a highly context-dependent framework for realigning such interests in the interpretation and enforcement of operating agreements.").

involving irreconcilably deadlocked owners will continue to create LLC litigation.[221] By adopting the Delaware "deadlock-plus" standard, New York courts, after finding the parties deadlocked, would still defer principally to the operating agreement before granting a petition for judicial dissolution. As evidenced by Delaware law, the "deadlock-plus" standard will not only allow New York courts to continue to promote the parties' freedom of contract, but will also reasonably and expeditiously allow individuals to get out of broken-down business relationships.

A. *The "Deadlock-Plus" Standard Comports with the Outcomes of* 1545 Ocean Avenue*,* Natanel*, and* Mizrahi

The future application of *1545 Ocean Avenue*, *Natanel*, and *Mizrahi*—three clear cases of deadlock—is fraught with uncertainty. Each case was highly fact specific and required the adjudicating court to do a fair amount of costly and time consuming fact-finding before determining whether dissolution should be granted or denied. Under the "deadlock-plus" standard, the decisions in each of the three cases would come out the same, but in a much more efficient and cost-effective manner.

If the "deadlock-plus" standard were applied to *1545 Ocean Avenue*, King's petition for dissolution would still be denied. In *Haley* and *Fisk Ventures*, the parties were deadlocked because the operating agreements at issue required a majority vote for the LLC to take any action, yet because of the parties' irreconcilable hostility, obtaining a majority vote was impossible, thereby preventing any decision-making. However, had the operating agreements in *Haley* and *Fisk Ventures* contained provisions permitting one party to unilaterally take action on behalf of the LLC, it is likely the court would have deferred to these contractual provisions in rejecting the judicial dissolution petitions premised on deadlock over management decisions. *1545 Ocean Avenue* aptly illustrates this scenario. The operating agreement at issue in *1545 Ocean Avenue* expressly permitted a manager to act unilaterally on behalf of the LLC[222]—under the "deadlock-plus" standard, the court

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221 It is unlikely LLC owners drafting operating agreements will have the foresight to spend the time and money consulting lawyers and drafting exit provisions that would prevent them from winding up in court. While a smart idea, it is unreasonable to expect that co-venturers (especially those who retain limited legal services) will begin the business by planning for the ultimate demise of their relationship and business. *See infra* Section III.B.

222 *In re* 1545 Ocean Ave., L.L.C., 893 N.Y.S.2d 590, 597 (App. Div. 2010) ("At any time when there is more than one Manager, *any one manager may take any action permitted under the Agreement,* unless the approval of more than one of the Managers is expressly required

could have denied the judicial dissolution petition, holding that, in accordance with the operating agreement, deadlock over management decision-making was effectively impossible.[223]

In *Natanel*, the court ordered judicial dissolution on the basis that the LLC was not achieving its stated purpose—a reasonable ruling if there actually was an operating agreement that contained a stated purpose. By permitting the parties (and their wives) to testify regarding the purpose of Y and Y upon its creation—which was never formally outlined in an operating agreement—the *Natanel* court wasted judicial resources when it could have ordered dissolution on the basis of a clear deadlock. If New York adopted the "deadlock-plus" standard, a disagreement over the business strategy and future of the LLC where majority consent was required would be sufficient for finding a deadlock warranting judicial dissolution.[224] Given that the default provision requiring majority consent under New York's LLC Law applied to Y and Y, and because there are no statutory remedies or tie-breaking provisions under the default rules, the court, applying the "deadlock-plus" standard, could have ordered dissolution on finding that Natanel and Cohen were deadlocked about the future operations of Y and Y.

The *Mizrahi* court ordered dissolution only after finding that the LLC was financially unfeasible, the second prong under *1545 Ocean Avenue*. Under the "deadlock-plus" standard, Mizrahi would have been able to petition for judicial dissolution on grounds that the parties were deadlocked *or* because the financial condition of the LLC prevented the business from operating.[225] The facts in *Haley* are almost analogous to those in *Mizrahi*: the stated purpose of the LLC was met, but the operating agreement required unanimous consent on management decisions and the parties were irreconcilably deadlocked. As such, the incapability of Mizrahi and Cohen to make any business decisions about the future of the LLC would have been a sufficient ground for judicial

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pursuant to the Agreement or the Act." (quoting the LLC operating agreement at issue in *1545 Ocean Avenue*)).

223 *See* Haley v. Talcott, 864 A.2d 86, 95 (Del. Ch. 2004). Unlike the contractual provision for unilateral decision-making in *1545 Ocean Avenue*, the court in *Haley* noted: "Haley never agreed to be a passive investor in the LLC who would be subject to Talcott's unilateral dominion." *Id.*; *see also* Fisk Ventures, L.L.C. v. Segal, No. 3017-CC, 2009 WL 73957, at *1, 4 (Del. Ch. Jan. 13, 2009). Again, unlike the contractual provision permitting unilateral decision-making in *1545 Ocean Avenue*, the contract at issue in *Fisk Ventures* required approval by at least seventy-five percent of the Genitrix Board in order to resolve business issues. 2009 WL 73957, at *2.

224 *See Haley*, 864 A.2d at 95 ("Finally, the evidence clearly supports a finding of deadlock between the parties about the business strategy and future of the LLC.").

225 *See Fisk Ventures*, 2009 WL 73957, at *4 (describing when judicial dissolution may be ordered).

dissolution on the basis of deadlock where the operating agreement provided no remedy.

Furthermore, under the framework set forth in *Haley*, the *Mizrahi* court could have granted Mizrahi's petition seeking a forced buyout given that liquidation was not an "adequate remedy," because it would not have "equitably effect[ed] the separation of the parties."[226] Notwithstanding any issues regarding personal guarantees, as in *Haley*, the *Mizrahi* court could have found that ordering a forced buyout would permit the LLC to proceed in the most practicable way. Instead, the *Mizrahi* court resorted to its "equitable jurisdiction" to create a remedy otherwise unavailable by statute.

B. *Counter Argument*

A critic of this proposal might argue that if New York adopted the "deadlock-plus" standard, LLC members would not be encouraged to execute comprehensive operating agreements that contain workable exit mechanisms, and instead would rely on courts to bail them out when things do not go as planned.

There are two responses to this argument. First, judicial dissolution has been, and will continue to be, a drastic remedy. Under the "deadlock-plus" standard, a petitioner cannot expect judicial dissolution solely upon a showing of deadlock. Rather, he must make a showing that the parties are deadlocked, the operating agreement provides no adequate remedy, and the business is unable to proceed without the cooperation of the parties. If the court finds that the operating agreement provides an adequate remedy or reasonable exit mechanism, the "deadlock-plus" standard requires enforcement of this mechanism rather than judicial dissolution. Moreover, even if a petitioner makes a showing of deadlock, judicial dissolution remains discretionary under the "deadlock-plus" standard.[227] Accepting deadlock as a ground for judicial dissolution would not signify New York becoming more lenient in its understanding of the gravitas of judicial dissolution, but rather would be in recognition of the impracticability of perpetually warring business owners.

Second, solutions which depend on attentive or rigorous drafting of operating agreements are unreliable given the vast differences in the quality of operating agreements, many of which are, at best, "off-the-

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226 *Haley*, 864 A.2d at 98.

227 *Id.* at 93 ("Here, even if I find that there are no facts under which the LLC could carry on business in conformity with the LLC Agreement, the remedy of dissolution . . . remains discretionary.").

shelf" forms. This was exemplified in *Mizrahi v. Cohen* where the parties hurriedly signed a boilerplate operating agreement drafted by the lawyer representing both of them, in an effort to expedite the real estate transaction.[228] Without the possibility of unlimited liability (as in general partnerships), LLC members are likely to be less cognizant of who and what they sign up for.[229]

CONCLUSION

While judicial dissolution is an extreme remedy, it is appropriate in certain situations. One of these situations is in cases of deadlock—if the management is utterly unable to make a crucial business decision, then it is "not reasonably practicable" to continue operations. By eliminating deadlock as a ground for judicial dissolution, New York courts are requiring LLC owners to provide exit mechanisms in the operating agreement or suffer the consequences of being forever attached at the hip. Because individuals are disinclined to plan for dissension at the start of a business relationship, New York LLC owners will continue to find themselves deadlocked with no remedy. The "deadlock-plus" standard, evidenced by Delaware law, is a viable approach to judicial dissolution in cases of deadlock by accounting for the context and reasonable expectations of the parties while still promoting principles of freedom of contract.

In just a few years, New York's LLC Law will celebrate its twenty-fifth birthday. As of 2017, the New York Court of Appeals has not had a word on the "not reasonably practicable" standard. This Note proposes that the Court of Appeals change New York's course and follow the lead of Delaware and adopt the "deadlock-plus" standard—the cost of personal relationships at the benefit of business is just not worth it.

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228 *See* Plaintiff's Trial Memorandum, *supra* note 157.

229 *See* Thompson, *Allocating the Roles*, *supra* note 15, at 373. As opposed to business entities with limited liability, the general partnership risk of unlimited liability for partnership debts encourages prospective co-partners to: (1) perform due-diligence to ensure compatibility and financial security prior to formation of the general partnership; and (2) once the partnership is formed, work at maintaining functional relations with co-partners for the duration of the partnership. *Id.*