

# THE DAILY RECORD

WESTERN NEW YORK'S SOURCE FOR LAW, REAL ESTATE, FINANCE AND GENERAL INTELLIGENCE SINCE 1908

## CivilLITIGATION

### Oppressive conduct insufficient to support LLC dissolution

LLCs, which were created by the New York Limited Liability Company Law (LLCL), are hybrid business entities that combine the tax aspects of partnerships with the limited liability of corporations. The two basic principles underlying the LLCL are (1) LLC owners (members) have flexibility in structuring the LLC through its operating agreement, and (2) the LLCL provides default procedures for an LLC, which apply unless the operating agreement clearly provides otherwise.

The LLCL is largely silent on the remedies available to a member facing another member's refusal to cooperate in the management of the business, or worse yet, another member's bad faith or intentional misconduct. As a result, judges and "business divorce" practitioners continue to wrestle with numerous questions about how to protect the rights of an LLC member from the misconduct of other LLC members.

In some instances, the courts have created non-statutory remedies derived by analogy from the Business Corporation Law (BCL), the Partnership Law and the common law, but in other instances the courts have denied aggrieved LLC members remedies which are not expressly provided in the LLCL.

For example, in *Tzolis v. Wolff*, the Court of Appeals held that LLC members may sue derivatively, even though the LLCL does not expressly authorize such actions, applying the law of trusts, corporations and limited partnerships. Similarly, in *Mizrahi v. Cohen*, a 2013 decision by the Second Department, the court, citing general equitable principles, held that the aggrieved member was entitled to the judicial dissolution of the LLC, and that the member was entitled to an order authorizing him to purchase defendant's interest in the LLC upon dissolution, even while acknowledging that the LLCL does not authorize such a buyout.

Nevertheless, the courts have held firm to the express terms of LLCL §702, which addresses judicial dissolution. That section empowers a court to dissolve an LLC "whenever it is not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement." In *Matter of 1545 Ocean Avenue, LLC*, the court analyzed the derivation of

LLCL §702, the dissolution provisions of the BCL and Partnership Law, and §702's "not reasonably practicable" standard.

Although the member seeking dissolution in that case had alleged "deadlock" between the managing members arising from one of the member's violations of the operating agreement, the court held that the member had to 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 entity to be realized or achieved, or (2) continuing the entity is financially unfeasible."

In its decision, the court cited *Widewaters Herkimer Co., LLC v. Aiello*, in which the Fourth Department held that allegations that the majority members breached their fiduciary duty to the aggrieved members and engaged in "unlawful or oppressive conduct toward them" were insufficient to plead the requisite grounds for dissolution under LLCL §702.

Recent decisions show that the courts are holding fast to that position. In a February 2013 case, *Doyle v. Ikon, LLC*, a member who had been "expelled" from the LLC sued for dissolution, alleging that he had been "systematically excluded from the operation and affairs of the company."

The First Department reversed the Supreme Court's order which denied defendants' motion to dismiss and granted that motion, finding that allegations of expulsion and systematic exclusion were insufficient to establish that it was no longer "reasonably practicable" for the company to carry on its business; the court noted that the company had been able to carry on its business after plaintiff was expelled and that the company was financially feasible.

In *Matter of Nunziata*, a July 2013 decision from the Queens Supreme Court, a member petitioning to dissolve an LLC alleged that the two managing members had: failed to allow him to participate or vote in business meetings; excluded him from all aspects and control of the business, to his financial detriment; and engaged in "oppressive conduct" toward him. The managing

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members cross-moved to dismiss the petition for failure to state a cause of action.

The court noted that the operating agreement provided for the management of the LLC by the managing members and set forth a limited number of "Dissolution Events." The court then found that the petition's allegations that the aggrieved member had been "systematically excluded" from the company's operations and affairs were insufficient to establish that it was no longer "reasonably practicable" to carry on the company's business, because they did not show that the management of the business was unable or unwilling to reasonably permit or promote the stated purpose of the entity, or that continuing the entity was financially unfeasible.

BCL §§1104 (deadlock) and 1104-a (oppression, fraudulent conduct, looting, waste or diversion of corporate assets) authorize an aggrieved shareholder to petition for judicial dissolution of a corporation in order to protect his interests. Partnership Law §63 authorizes an aggrieved partner to seek dissolution when another partner willfully or persistently commits a breach of the partner-

ship agreement or when other circumstances "render a dissolution equitable."

Therefore, both statutes give an owner of a business a mechanism to extricate himself and his investment from that business upon a showing that the internal relationships between that owner and the other owners are dysfunctional and untenable.

In sharp contrast, an owner of a business operated as an LLC has no statutory mechanism to extricate himself from a similarly dysfunctional and untenable internal relationship as long as the business can continue operating (to the outside world) on a financially feasible basis. While this anomaly exists, it is critical that LLC members take steps to control their own destinies and prevent a default to the LLC, through well-crafted operating agreements which include provisions addressing management decision-making and withdrawal procedures such as buyouts and non-judicial dissolution.

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