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Outside Counsel

Business Divorce Cases of 2020


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The pace of business divorce litigation has proven impervious to economic busts and booms, and now pandemics as well. The courts have more than risen to the occasion, quickly adapting to virtual appearances by counsel, managing ever-crowded dockets with the help of remotely located staff, and—we are happy to report—handing down numerous, important decisions in disputes between co-owners of closely held firms.

Last year's most notable decisions predominantly involve disputed buyouts in statutory fair-value appraisal proceedings and pursuant to buy-sell agreements. These include a so-called "shotgun" buy-sell agreement that misfired and an appellate decision of apparent first impression in which the court rejected a "double dipping" claim by a minority owner for post-valuation date distributions. First up, however, is an important ruling that ordered dissolution of a limited partnership by operation of law under rarely invoked provisions of the Revised Limited Partnership Act.

Novel Issues and Disputes Over Contractual Buyout Provisions. Last year witnessed first impression rulings in the business divorce arena from the Manhattan Commercial Division. In *Weinstein v. RAS Prop. Mgt.*, 67 Misc.3d 240 (Sup. Ct. NY County 2020), the court wrestled with contractual and statutory provisions addressing partnership dissolution and partner withdrawal in the context of a realty-holding partnership governed by the Revised Limited Partnership Act (RPLA).

After originally filing for judicial dissolution of the partnership under RPLA §121-802, and after a receiver was appointed in an unrelated third-party arbitration proceeding against the partnership, the estate of the plaintiff limited partner amended its petition to request non-judicial dissolution by operation of law based on the combined force of RPLA §§121-402 and 121-801. The former statute mandates, unless otherwise provided in the partnership agreement, that a general partner automatically is deemed to have withdrawn from the partnership if a dissolution proceeding brought against the general partner is not dismissed or stayed within 120 days, or if the appointment of a receiver for the general partner is not vacated or stayed within 90 days. The latter statute authorizes non-judicial dissolution and winding up of the limited partnership upon "an event of withdrawal of a general partner" unless within 90 days "not less than a majority in interest of the limited partners agree in writing to continue the business of the limited partnership."

The general partner moved to dismiss, arguing that the partnership agreement's provision enumerating events of dissolution other than those specified in the two statutes, none of which had occurred, displaced the statutory fault rules concerning withdrawal events and dissolution. The estate cross-moved for summary judgment on its dissolution claim.

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The court elevated statute over contract and sided with the estate, ruling as a matter of first impression that (1) the partnership agreement "does not provide an exhaustive list of events which constitute a general partner withdrawal or otherwise explicitly opt-out of Section 121"; (2) there was no stay or dismissal of the dissolution proceeding prior to the 120th day following its filing; and (3) the general partner withdrew and ceased being the general partner "because a receiver was appointed over the Partnership's assets" in the

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arbitration and was not vacated within 90 days. The court's rulings in *Weinstein* are particularly noteworthy in light of the Court of Appeals' 2018 decision in *Congel v. Malfitano*, in which the high court proclaimed that "where the agreement clearly states the means by which the partnership will dissolve, or other aspects of partnership dissolution, it is the agreement that governs the change in relations between partners and the future of the business."

The Manhattan Commercial Division also addressed novel questions of substance and procedure last year in *Yakuel v. Gluck*, 2020 NY Slip Op 31251[U] (Sup. Ct. NY County, May 7, 2020), in which co-owners of a successful digital marketing LLC battled over what the minority owner dubbed a "rigged" contractual buyout provision in an amended operating agreement.

The amendment in question—effectively a single-appraiser valuation process labeled as a "repurchase option"—could be unilaterally exercised by the majority owner "at any time"; was governed by the "fair market value" standard of value, expressly allowing for minority and marketability discounts; and designated the majority member as the sole engaging party for retention of the third-party appraiser. The minority owner claimed he was "lured" into signing the amendment by the majority member's assurance that the option was only there in the event of an insurmountable dispute over operation of the business. As it happened, the majority owner exercised the repurchase option two days after the amendment was executed, which ultimately resulted in a valuation that the minority member claimed was grossly deflated and the product of a "rigged" appraisal process from which he had been excluded.

The battle over the process by which the valuation came about ensued in the context of a relatively rare appraisal-enforcement proceeding under CPLR 7601. Such a proceeding, as discussed at length by the court at the outset, is governed by a standard akin to challenging an arbitration award, allowing for "extremely limited" judicial review and permitting the court to set aside an appraisal only in the face of a denial of "the fundamental right" of a party to an appraisal process to have the appraiser receive "all pertinent evidence offered."

The majority owner petitioned the court for confirmation of the appraisal report at issue, arguing that he "permitted [the minority member] to participate in the appraisal process, including by providing information and arguments to [the appraiser]." The minority member cross-petitioned to vacate the report, arguing that the majority "blocked him from participating meaningfully in the appraisal process" and that he "never had an opportunity to participate, present evidence, or object to false inaccurate evidence provided by [the majority]." The court found "some support"

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on both sides of the argument, denied both petitions without prejudice, and sent the parties off to conduct further discovery on "the core question [of] whether the facts support [the minority owner's] assertion that he did not have a fair opportunity to present his case."

Disputes Over 'Shotgun' Buy-Sell Agreements. Speaking of buyout agreements, the Manhattan Commercial Division last year in *Lard-PT v. Seokoh*, 69 Misc.3d 1207[A] (Sup. Ct. NY County 2020), also was asked to enforce a "shotgun" buy-sell agreement between two 51%/49% members of a manager-managed cosmetics manufacturer who had equal voting rights as to their respective board designees on the LLC's board of managers. The company's operating agreement provided for a procedurally complex buyout procedure in the event of deadlock over a major decision, which required unanimous consent, or other breach of the agreement.

In short, the procedure allowed for the "Initiating Member" to offer to purchase the "Other Member's" interest at a specified price, in response to which the "Other Member" would have the option to timely purchase the "Initiating Member's" interest at the same (pro-rata) price. The buy-sell provisions otherwise were silent regarding other terms and conditions of the transaction. Once triggered, if either member ran afoul of the procedure as stated, the "non-defaulting Member" had the option to proceed as initiated or to reverse the transaction at a 30% discount or premium depending on how the member chose to proceed.

Following the installation by the 49% member of a successor CEO without the 51% member's required consent, the 51% member as Initiating Member triggered the shotgun procedure under the operating agreement by notice, offering to sell its own interest for $10.4 million or to purchase the interest of the 49% member as the "Other Member" for the price of $10 million. The Initiating Member's offer was conditioned on the purchaser assuming guarantees given by the seller in connection with outstanding company loans.

The Other Member responded to the notice by agreeing to purchase the Initiating Member's interest for $10.4 million but claimed that because the added condition concerning the guarantees was not contemplated by the agreement, its purchase would be contingent upon the acceptance of the Other Member's own extra-contractual conditions, including the extension of a company lease and the immediate resignation of the Initiating Member's board designees.

After nearly a year of negotiations, the Initiating Member gave notice that the Other Member was in default of the buy-sell provisions for conditioning its proposed purchase on the lease extension and board resignations, and that it therefore was exercising its option to reverse the transaction and purchase the Other Member's interest. The parties ultimately sought judicial intervention and asked the court to enforce their respective interpretations of the "shotgun" procedure in the operating agreement.

The court sided with the Initiating Member, finding that the Other Member breached the operating agreement in three respects, including by unilaterally installing a substitute CEO, interposing unreasonable terms and conditions on its proposed contractual buyout, and failing to close on the transaction initiated by the Initiating Member. The court rejected the Other Member's argument concerning the Initiating Member's own conditional offer, finding it "commercially reasonable" to require an assumption by the purchaser of the seller's guaranty of outstanding corporate debt since "no one would expect to have to continue to guaranty loans in a business that they are exiting."

Contested Fair-Value Appraisal Proceedings. Valuation issues arising out of fair-value appraisal proceedings under §§623 and 1118 of the Business Corporation Law (BCL) and §1005 of the Limited Liability Company Law (LLCL) have become common fodder for this column over the years. That trend continued last year as illustrated by a pair of decisions by the Nassau County Commercial Division and the Appellate Division, Second Department.

In *Magarik v. Krauss USA*, the Nassau County Commercial Division addressed interesting valuation issues in the context of an appraisal proceeding under BCL §1118 after the respondent majority shareholders in an online distributor of plumbing fixtures elected to purchase the interest of their minority shareholder when he petitioned for dissolution of the company, alleging oppression under BCL §1104-a. The dispute over the value of the petitioner's 24% interest in the company culminated in a seven-day trial featuring a "battle of the experts" but which also showcased—at least from the petitioner's perspective—certain certified representations made by all three owners in connection with their application to double their $5 million line of credit with a local bank. The representations made to the bank included a projected 40% increase in company sales for the following fiscal year and personal financial statements from the respondents and petitioner alike, each valuing the company at $30 million.

Coincidentally or not, the petitioner's expert valued the company at just over $30 million—and, by extension, the petitioner's interest at $7.2 million—without applying any discount for lack of marketability (DLOM). The respondents' expert, by stark contrast, valued the company at just over $6 million—and, by extension, the petitioner's interest at $1.1 million—after applying a 25% DLOM.

The court was less than persuaded by the $30 million valuation of the petitioner's expert, describing his proposed company projections as "unrealistic," "optimistic," "ambitious," and "overstated." The court gave similar back-of-the-hand treatment to the petitioner's emphasis on the parties' contemporaneous, certified representations of value, finding that "the court need not comment further on representations made by the parties to [the bank] in order to secure a loan, or what reliance may have been placed on such representations by [the bank], except to note that, ultimately, the representations were not accurate."

Instead, the court credited the $6 million valuation of the respondents' expert, finding it to be a "realistic assessment of [the company's] fair value," including the application of a DLOM because "the shares of [the company], a close corporation, cannot be readily sold on a public market." The court, however, reduced the DLOM proposed by the respondents' expert to 5%, resulting in a fair-value award for the petitioner's interest of just under $1.4 million.

Finally, in *PFT Tech. v. Wieser*, 181 A.D.3d 836 (2d Dept. 2020), the Second Department affirmed novel rulings by the Nassau County Commercial Division in a fair-value appraisal proceeding involving a minority member's interest in an LLC. The court agreed with the lower court's conclusion that, when not otherwise established by agreement or statute, the valuation date for purposes of determining the fair value of a minority owner's interest may be fixed in the court's discretion "by reference to the equities of the case." The court also upheld the lower court's finding that the minority member was not entitled to be paid for the value of his interest in the company plus "unpaid distributions made after the valuation date" since such distributions would be considered "double dipping."