Shareholder Wars: Internal Disputes In Close Corporations Do Not Always Lead to Judicial Dissolution

BY PETER A. MAHLER

New York courts have long struggled with the question of whether a breakdown in personal relations between two 50% shareholders in an otherwise viable closely held business corporation warrants judicial dissolution. The answer has fluctuated, with some courts emphasizing the company's financial viability and others the loss of trust between the co-owners, as warring factions duel over the myriad business and personal disputes that can and often do erupt in close corporations.

A recent Appellate Division decision, in a contest between 50/50 owners of a close corporation that owned a number of apartment buildings, suggests anew the need for counsel in such cases to focus their presentation on the equities that militate for or against dissolution.

In the decision, *In re Fazio Realty Corp.*,[1] the Second Department dismissed a dissolution petition despite acknowledging undisputed evidence "that there exists considerable and apparently ever-increasing internal corporate conflict." The court focused on the petitioner's failure to show that the dissension precluded the "successful and profitable conduct of the corporation's affairs."[2] Denied a divorce, the *Fazio* shareholders presumably went home and continued profitably to throw frying pans at one another.

Section 1104(a) of the Business Corporation Law (BCL) authorizes a petition for judicial dissolution on any one of three grounds by holders of 50% of the corporation's voting stock. The first two grounds concern deadlock at the board and shareholder levels. Specifically, BCL § 1104(a)(1) authorizes dissolution when the votes required for board action cannot be obtained due to division among the directors as to management of the corporation's affairs. BCL § 1104(a)(2) authorizes dissolution when the shareholders are so divided that the votes required for the election of directors cannot be obtained.

The focus of this article is the third ground, contained in BCL § 1104(a)(3). This section authorizes a dissolution petition when "there is internal dissension and two or more factions of shareholders are so divided that dissolution would be beneficial to the shareholders." The inherently elusive definitions of "internal dissension" and "beneficial to the shareholders," together with the lingering influence of decisions pre-dating the enactment of BCL § 1104(a)(3), have made it difficult for the courts to create any bright-line rules or otherwise lend predictability to petitions brought under the section.

The Dissolution Dynamic

Dissolution petitions brought by 50% shareholders almost always rely on the catch-all ground of internal dissension. More often than not they also rest on one or both of the deadlock provisions. In many instances, however, allegations of deadlock fall short because the shareholders have never followed corporate formalities such as holding shareholder meetings or board elections.[3] The petition, therefore, may stand or fall on the petitioner's ability to demonstrate internal dissension and benefit to the shareholders from dissolution, terms not defined in the statute.

A petition for judicial dissolution under BCL § 1104 usually follows a period of mounting tension between the two 50% factions, and a failure by the principals to reach an accord for one to buy out the other or to sell the business to a third party or to find some other non-judicial means of achieving a business divorce. The dynamics often are such that one faction feels that just by bringing a dissolution proceeding it can gain an advantage in buy-out negotiations. Particularly in service companies without long-term customer contracts, the faction that believes it controls the customer relationships, and

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therefore can walk off with the dissolution spoils, may feel that blowing up the company is its best option. For the same reasons, the other 50% faction has a strong incentive to fight dissolution.

The BCL § 1104 dynamic is heavily influenced by the absence of a statutory buy-out right. In contrast, a dissolution petition brought under BCL § 1104-a for shareholder oppression gives the other shareholders the absolute right to avoid dissolution by electing to purchase the petitioner's shares for fair value under BCL § 1118.[4] The typical BCL § 1104-a petitioner is a minority shareholder looking to be bought out by the majority shareholder who likely is the natural buyer. In a 50/50 corporation there may be no one natural buyer. In other words, even though a 50% shareholder also has standing to seek dissolution under BCL § 1104-a,[5] he or she is unlikely to do so (*i.e.*, will be unable to avoid the BCL § 1118 trigger) if the game plan is to break up the company or to gain the negotiating edge in a voluntary buy-out.[6]

The real challenge for the respondent's counsel is to answer the petitioner's accusations without resorting to highly personal attacks against the petitioner and thereby playing into the petitioner's hand.

Once the proceeding is started, the interplay between the petitioner and the respondent usually follows a standard pattern. The petitioner alleges that on one or more business issues invariably described as critical, the two 50% factions are at complete odds and that their inability to reach a consensus is crippling the company's business relations and profitability. Savvy petitioner's counsel will spice the petition with allegations of devious or at least boorish behavior by the respondent shareholder in the hope of provoking tit-for-tat mudslinging in the respondent's answering papers. "You see, Judge," petitioner's counsel will urge at the initial hearing, "regardless of who's right or wrong, these parties obviously detest one another. They need a divorce!"

The respondent's answering papers ordinarily downplay management conflicts and point out that the shareholder-managers are still performing their respective duties, and that the company remains profitable. If the company has any non-shareholder employees, the "public" interest in keeping them employed and paying taxes will be trumpeted. The real challenge for the respondent's counsel – particularly when dealing with a client angered by what he or she perceives as betrayal by a business partner – is to answer the petitioner's accusations without resorting to highly personal attacks against the petitioner and thereby playing into the petitioner's hand. This usually is handled by trying to show that the petitioner is seeking dissolution in bad faith, *e.g.*, the petitioner has a separate business that will benefit from dissolution, or is using dissolution to steal customer relationships for a new business excluding the respondent, or is using dissolution to side-step buy-sell provisions in a shareholders' agreement.[7]

No matter how smartly played on both sides, the inescapable fact not lost on the court is that the co-equal business owners, for whatever reason, are not getting along. Should that be enough to grant, in effect, a no-fault business divorce, or should the court probe more deeply into the bona fides and depth of the alleged dissension? BCL § 1104(a)(3) also requires a finding that the shareholders are so divided that dissolution would be "beneficial to the shareholders." Beneficial how? Financially? Emotionally? Should the court give any consideration to the survival interests of the corporation as an entity distinct from its owners?

The Lead-Up to the Internal Dissension Statute

To address these questions it is helpful to understand the derivation of BCL § 1104, and the case law that preceded the addition of internal dissension as a ground for dissolution as part of the corporate law overhaul, culminating with the enactment of the BCL in 1961.

Statutory authority for judicial dissolution of New York corporations reaches back to the early 1800s.[8] During most of the 19th century, judicial dissolution was limited to petitions brought by a majority of the directors based on insolvency or because dissolution would be beneficial to the shareholders and not injurious to the public interest.[9] In 1876 judicial dissolution authority expanded to include petitions based on director and shareholder deadlock regarding management of the corporation's affairs, still requiring a showing of benefit to the shareholders and lack of injury to the public interest.[10]

In 1944, an amendment to § 103 of the General Corporation Law[11] (GCL) added a second ground for dissolution based on shareholder deadlock with respect to the election of a board of directors.[12] GCL § 117 mandated dissolution based on deadlock ("the court must make a final order dissolving the corporation"[13]) so long as the court also found that dissolution would be beneficial to the shareholders and not injurious to the public.

One of the earliest cases construing the 1944 amendments is the First Department's 1949 opinion in *In re*

Cantelmo,[14] where it reversed the trial court and denied a 50% shareholder's dissolution petition. The petitioner alleged "hopeless deadlock" between the shareholders, who were unable to agree upon a third, impartial director and therefore could not elect a board to control the corporation's business. The court disagreed, noting that the business was functioning actively and profitably, and that the petitioner had made no bona fide effort to agree upon a third director. Rather, the court found that the petitioner's object was "to force respondent out of the business and, in effect, to obtain for himself . . . the benefits to the corporation built up over the years by the joint efforts of both parties."[15]

Cantelmo obviously was no shareholder love-fest. The dissenting opinion refers to "two 50% stockholders, in irreconcilable dissension and engaged in constant legal warfare under circumstances where corporate success and efficiency imperatively demand co-operation."[16] Yet the court refused a business divorce, essentially ruling that the petitioner's bad faith and the company's profitability negated any finding of benefit to the shareholders.

To similar effect is a trial court decision several years later in *In re Bankhalter*,[17] denying a motion to vacate an order of reference on a dissolution petition.[18] The opinion describes "numerous disputes, marked with an acrimony reminiscent of matrimonial litigation," but then goes on to say that "not every unresolved conflict in corporate management is fatal. The stymie must pertain to matter material and essential to the existence of the corporation."[19]

The emphasis on corporate viability rather than the erosion of the shareholders' relationship seems to reach its pinnacle in a pair of decisions in 1954 by the Court of Appeals in *In re Radom & Neidorff*[20] and *In re Seamerlin Operating Co.*[21]

Radom involved a profitable music printing and lithography company in business for more than 30 years, owned equally by estranged siblings, one of whom sought dissolution based primarily on the other's refusal to co-sign his salary checks. The petitioner was president and ran the business by himself. The trial court held that the many accusations and counter-accusations in the parties' submissions showed a "basic and irreconcilable conflict between the two stockholders requiring dissolution, for the protection of both of them, if the petition's allegations should be proven" at a hearing.[22]

On interlocutory appeal, the Appellate Division reversed and dismissed the petition, citing an increase in the corporation's profits during the pendency of the proceeding and finding that the petitioner's failure to receive salary did not frustrate the corporate business and was remediable by means other than dissolution.[23]

The Court of Appeals affirmed. Finding it undisputed that "these two equal shareholders dislike and distrust each other" and that the petitioner "is in an uncomfortable and disagreeable situation for which he may or may not be at fault," the Court nonetheless held, "[t]here is no absolute right to dissolution under such circumstances."[24] The Court then added:

> Even when majority stockholders file a petition because of internal corporate conflicts, the order is granted only when the competing interests "are so discordant as to prevent efficient management" and the "object of its corporate existence cannot be attained." The prime inquiry is, always, as to the necessity for dissolution, that is, whether judicially-imposed death "will be beneficial to the stockholders or members and not injurious to the public."[25]

Three months later, the Court of Appeals decided *Seamerlin* where it reversed the Appellate Division's affirmance of a trial court order granting a dissolution petition. *Seamerlin* involved a single-asset real estate operating company that subleased portions of a commercial building to a separate business owned by one of the two shareholders and to a third-party business. The company consistently paid salary and dividends to its owners.

The petitioner sought dissolution based on director and shareholder deadlock. The petition accused the respondent shareholder, who had been judicially declared incompetent shortly before the proceeding, of various corporate improprieties, of using vile and abusive language and of threatening the petitioner with bodily harm. A referee reported that the dissolution should be denied because management was not paralyzed, the company was making a profit, and a sale of the corporation's leasehold interest would not realize much, if any, cash. The trial judge disagreed with the referee's findings and ordered dissolution, and the Appellate Division affirmed.[26]

The Court of Appeals' reversal turned primarily on the trial court's inability to overrule the findings of a referee appointed to hear and determine. More important for present purposes is the Court's narrowly framed dissolution standard, as follows:

> There were three questions of fact presented in the present case: (1) were the directors of Seamerlin unable to agree on a matter of corporate management; (2) would dissolution be non-injurious to the public; and (3) would dissolution be beneficial to the shareholders. All three questions must be answered in the affirmative before a dissolution will be warranted or may be ordered. Two of them were decided adversely to petitioner by the Referee.[27]

Buy-Sell Agreements Can Avert Dissolution Trauma

Paying a lawyer to prepare a well-tailored shareholders' agreement is not how most co-owners of a new business want to spend their scarce start-up dollars. Just as discussion of a pre-nuptial agreement may be anathema to betrotheds, co-owners in the bloom of a promising new business relationship may be ill-disposed to contingency planning for its demise.

Considering the modest life span of most multi-owner businesses, however, such planning makes consummate sense and is a highly worthwhile investment that can avert the uncertainty and trauma – both personal and financial – that typically accompanies judicial dissolution proceedings.

Shareholders' agreements can cover a wide range of corporate governance and ownership issues. Restrictions on stock transfers and provisions for buy-out of departing shareholders are among the most important features and litigation preventives.

There are many considerations in designing a buy-sell agreement. Here are just a few of them:

• Should the buy-back of shares, either by the company or the remaining shareholders, be optional or required? If a shareholder dies, a mandatory buy-back can prevent the remaining shareholders from having to take on as new partners the deceased shareholder's survivors, who typically are not employed by the company and whose interests usually conflict with that of the remaining shareholders. The buy-back often is funded by life insurance policies owned either by the corporation under a stock redemption agreement or by the shareholders under a cross-purchase agreement.

• Under what circumstances can a shareholder voluntarily sell his or her shares, and to whom? The right of first refusal is the most prevalent voluntary buy-sell mechanism for keeping shares out of the hands of strangers. The selling shareholder must present any bona fide third-party offer to the other shareholders of the company, who then have a stipulated time period within which to match the offer.

• What if there is no anticipated outside buyer for the shares? For many co-owned businesses there is no market for a non-controlling interest and a first refusal therefore does not provide an exit. A common alternative is the "shotgun" buy-sell agreement whereby a shareholder offers either to sell to the other shareholder or be bought out at the same price. Not knowing whether the other shareholder is a buyer or seller gives the offeror a strong incentive to set a fair price. A shotgun agreement is not advisable, however, for a shareholder with substantially lesser resources than the other.

• If there is no outside buyer and the shotgun approach is too uncertain, are there other valuation methods? There are any number of ways to stipulate value in the shareholders' agreement, including fixed share price with annual updates; book value; formulas such as multiple of net after-tax income plus net asset value; and valuation by the company accountant or an independent appraiser.

• Should the shareholders' agreement encourage a sale of the entire business as opposed to the separate shareholders' interests? "Tag-along" and "drag-along" provisions can be used to facilitate such a sale when Shareholder A finds a buyer by giving Shareholder B the right to be bought out (tag-along) or requiring Shareholder B to sell (drag-along) on the same terms and conditions.

• Can the commencement of a dissolution proceeding itself trigger a mandatory buy-out? The Second Department gave an affirmative answer in *In re Doniger*,[1] where the shareholders' agreement compelled sale upon "passage or disposition of shares in any voluntary or involuntary manner whatsoever, including but not limited to . . . judicial order, [or] legal process."

1. 122 A.D.2d 873, 505 N.Y.S.2d 920 (2d Dep't 1986).

The last notable decision predating the statutory addition of internal dissension as a separate ground for dissolution is *In re Pivot Punch & Die Corp.*[28] In *Pivot Punch*, a 50% shareholder whose employment by the corporation was terminated by a prior arbitration award, and who subsequently had no voice in the management of the business and received no income, sought dissolution based on the inability to elect a board of directors. The trial court, in a decision written by then-Justice Matthew Jasen before his elevation to the Court of Appeals, held that the petition prima facie set forth adequate grounds for dissolution, and granted a hearing.

Judge Jasen's analysis of the statutory requirement – that dissolution be beneficial to the shareholder – is significant as the first New York dissolution decision equating a close corporation and a partnership. As Judge Jasen wrote:

> In determining what is beneficial to the stockholders, the court must take into consideration the type of cor-

> poration we are dealing with in this case. We have here what is generally referred to as a close corporation, "one that has been organized by an individual or a group of individuals seeking the recognized advantages of corporations . . . but regarding themselves basically as partners."[29]

Judge Jasen next observed that the subject corporation "is simply a partnership consisting of [the petitioner and respondent], clothed with the benefits peculiar to a corporation, limited liability perpetuity and the like."[30] The opinion also cited federal tax law permitting close corporations to elect pass-through tax treatment as partnerships, and partnership law permitting dissolution at will.[31] Judge Jasen then turned to the heart of his analysis:

> In addition to the technical rules surrounding a partnership and perhaps from a purely moral point of view, more important, there exists between partners the highest degree of fidelity, loyalty, trust, faith and confidence. When these characteristics in a partnership cease, then the true partnership ceases, and when these characteristics cease between owners of equal, or verily, substantially equal, shares in a close corporation, the close corporation ceases to be beneficial to the deadlocked stockholders. In the opinion of this court, the benefit to the stockholders within the meaning of article 9 of the General Corporation Law, is adequately alleged.[32]

Pivot Punch's emphasis on the partner-like bonds and mutual fidelity of shareholders in close corporations is a significant counterpoint to cases such as *Cantelmo*, *Radom* and *Seamerlin*, which focus on corporate viability. As seen below, in the decades since the enactment of BCL § 1104(a)(3) authorizing dissolution based on internal dissension, persuading the court to view a contest between 50% shareholders, on the one hand, as more akin to a partnership dispute or, on the other hand, as a fight over corporate policies and viability, can make the difference between the grant and denial of a dissolution petition.

Adoption of Internal Dissension As Ground for Dissolution

The GCL and Stock Corporation Law were overhauled and consolidated in the new BCL enacted in 1961 and made effective in 1963. Provisions for judicial dissolution were codified in BCL Article 11. BCL § 1104, entitled "Petition in case of deadlock among directors or shareholders," included a new provision in subparagraph (a)(3) permitting dissolution on the ground of internal dissension. The legislative history indicates that the purpose of the new subparagraph "is to make clear that dissension between factions of shareholders, particularly in small corporations, which makes continued association unworkable and the continuance of the corporate business no longer advantageous to the shareholders, is also a reasonable ground for dissolution."[33]

Additional changes were made in BCL § 1111. BCL § 1111(a) expressly provides that dissolution of a corporation is within the court's discretion. BCL § 1111(b) also specifies criteria that the court "shall take into consideration" in making its decision. First, "the benefit to the shareholders of a dissolution is of paramount importance."[34] Second, "dissolution is not to be denied merely because it is found that the corporate business has been or could be conducted at a profit."[35] The absence of injury to the public interest is no longer a criterion as in the predecessor statute.[36]

The express addition of internal dissension as a separate ground for dissolution in BCL § 1104(a)(3), together with the de-emphasis on corporate profitability and the omission of the public-injury inquiry as dissolution criteria in BCL § 1111, suggest a legislative intent to liberalize the circumstances under which 50% shareholders can petition (as the *Radom* court put it) for the "judicially imposed death" of a close corporation. The case law in the decades following enactment of the BCL, however, indicates that the liberalization has taken hold sporadically and that, as in the Second Department's *Fazio* decision cited at the beginning of this article, corporate viability and profitability often trump shareholder acrimony.

Cases Denying Dissolution

Fazio is one of several significant appellate decisions denying dissolution petitions based on internal dissension, in which the courts seemingly elevate concern for the corporate body and fisc over the breakdown of mutual trust and loyalty between business partners.

In *In re Dubonnet Scarfs, Inc.*,[37] a divided First Department panel affirmed the dismissal without a hearing of a dissolution petition brought by 50% shareholders of a profitable knitwear manufacturing company with 61 employees. The record included evidence that the company had $2 million cash and another $1 million in near-liquid receivables. The respondent 50% shareholder had served as the company's CEO for 30 years; he denied the petitioners' allegation that he misrepresented his agreement (never implemented) to purchase their interest at fair value.

The majority found that internal dissension had not resulted in any deadlock and that the "only reason" the petitioners sought dissolution was to raise cash to satisfy their personal creditors. "Needless to say," the majority wrote, "the mere fact that a closely held corporation may have substantial liquid assets, and a stockholder has personal financial problems totally unrelated to the corporation do not, in and of themselves, state grounds for judicial dissolution" under the BCL.[38]

The *Dubonnet* dissent argued that internal dissension as used in the statute was intended to augment dead-

lock and is not limited to dissension respecting management of the corporation's affairs. Rather, it is broad enough to encompass the alleged internal dissension regarding the use of the corporation's substantial liquid assets. The dissent also pointed to BCL § 1111(b)(3)'s provision that the continued making of a profit by the corporation is not a bar to its dissolution.[39]

The dissension-leading-to-deadlock formulation in *Dubonnet* reappears in *In re Kaufman*.[40] There, the Second Department affirmed an order dismissing a dissolution petition where the "petitioner failed to demonstrate that the dissension between him and the respondent has resulted in a deadlock precluding the successful and profitable conduct of the corporation's affairs" or that the parties' disagreements "posed an irreconcilable barrier to the continued functioning and prosperity of the corporation."[41]

A number of significant decisions . . . conclude that the benefit to the warring shareholders from a business divorce outweighs the interest in continuing the corporate business.

In *In re Glamorise Foundations, Inc.*,[42] the First Department vacated a dissolution order and remanded the case for trial. The lower court had ordered dissolution under BCL § 1104(a)(3) based on the owners' disagreement over a business plan proposed by one of them, finding that "the relationship between the two principals had markedly deteriorated."[43] The appellate court disagreed, writing:

> The fact that the parties disagree over petitioner's plan for the company's future is not dispositive of the fundamental issue of whether the conditions of the statute have been satisfied such that the extraordinary step of judicial dissolution is warranted. And the initiation of this proceeding alone – or even the existence of multiple lawsuits between the parties – is similarly insufficient for this purpose.[44]

The *Glamorise* opinion notes the existence of multiple lawsuits between the parties and the issuance of a restraining order in the case before it. Intimating the rancorous tone of the parties' filings, the court added that

> the tenor of the lawsuit cannot be cited to bootstrap the arguments made or justify the relief sought. It is [respondent's] contention that petitioner deliberately created the underlying dispute for the very purpose of securing judicial dissolution and thereafter seizing the corporation for himself, his son and other management personnel. Indeed, despite the posturing of the parties, the corporation continues to flourish. It is petitioner's contention that the heart of the dispute involves the direction that the corporation will take in the future. Whether the differences on this issue are genuinely irreconcilable or terminal to the well-being of the corporation are among the issues to be determined at a hearing.[45]

In *In re Parveen*,[46] the First Department reversed an order of dissolution rendered after a trial between 50% owners of a pharmacy business. The opinion notes that the "relationship between the parties eventually broke down" over the issue of capital contributions. Nonetheless, the court found BCL § 1104 "inapplicable" because the petition "merely" alleged that there was only one shareholders' meeting since the venture's inception and that financial information was not regularly disseminated. The court also held that the petitioner's claim, that the respondent exercised sole control over the corporation's daily management, "does not create a cause of action for dissolution, because there are no allegations that [the respondent's] control gave rise to deadlock over a management decision."[47]

Cases Granting Dissolution

On the other side of the ledger are a number of significant decisions at the appellate and trial court levels granting dissolution petitions based on internal dissension, in which the courts conclude that the benefit to the warring shareholders from a business divorce outweighs the interest in continuing the corporate business.

In *In re Sheridan Construction Corp.*,[48] the Fourth Department affirmed a dissolution order involving five related corporations in the construction business owned equally by two brothers. The court observed that "fraternal strife resulted in a bitter feud," that there was "no hope of reconciliation between these two brothers in the 'foreseeable future,'" and that they could find "no common ground of agreement in any respect."[49] The brothers' disagreements and the intensity of their discord became so great that efficient management became "impossible" and therefore dissolution would benefit the shareholders and was the "only practical and feasible solution."[50]

In re Surchin[51] is a trial court decision granting dissolution based on deadlock and "serious internal dissension between the two parties" involving threats of personal violence, surreptitious monitoring of telephone calls and financial improprieties by the respondent. The court stated that in considering whether dissolution would be beneficial to the shareholders within the statute's meaning, the term includes "the mental and

physical well-being of a shareholder as well as financial gain to him."[52] The court's opinion relies heavily on *Pivot Punch*'s analogy of shareholders in close corporations to partners, and comments that "dissolution would be in order even if money was being made quite fully and readily by the corporation."[53]

In *In re Gordon & Weiss, Inc.*,[54] the First Department affirmed a dissolution order entered without a hearing, involving a profitable advertising business. The petitioner sought dissolution after trying unsuccessfully to buy out the respondent, and following several other lawsuits between the owners. The respondent accused the petitioner of bad faith in seeking dissolution based on nothing more than his desire not to continue in business with the respondent.

In affirming dissolution, the court stated that "this is a service corporation" in which client services are performed by the two owners who "are not working together." The court also referred to BCL § 1111(b)(3) as a change from the "earlier thinking" (for which it cited *Radom*) which "stressed the distinction between the corporation as an entity and the shareholders, and as long as the former could continue to function profitably the relationship between the shareholders was of no moment."[55] Noting that the relationship between shareholders in a closely held corporation "closely approximates the relationship between partners," the court reasoned that "when a point is reached where the shareholders who are actively conducting the business of the corporation cannot agree, it becomes in the best interests of those shareholders to order a dissolution."[56]

The First Department affirmed another dissolution order in *In re T.J. Ronan Paint Corp.*,[57] involving a ferocious dispute between two 50% owners of a paint manufacturing business. The dissolution proceeding was preceded by protracted litigation including fraud claims between the two 50% owners, during which one of them was excluded from the corporation's offices. The trial court found that the "massive" court files evinced "bitter antagonistic dissension" between the parties, including attempts to secure intervention by the district attorney.[58]

On those facts the appellate court held that the "degree of dissension, reflected by the intense personal hostility, poses an irreconcilable barrier to the continued functioning and prosperity of the corporation, a hopeless deadlock which mandates dissolution as the only viable remedy."[59] As in *Gordon & Weiss*, the court opined that the loyalty and good faith expected of shareholders in close corporations, as in partnerships, is destroyed when "dissension becomes the order of the day."[60]

Finally, in *Goodman v. Lovett*,[61] the Second Department affirmed a dissolution order entered without a hearing where the two owners had not spoken with each other in years after disagreeing over profit distributions. The differences and animosity between the shareholders were sufficient to prevent the continued efficient operation of the corporation without regard to the underlying reasons and without ascribing fault. "Rather, the critical consideration is the fact that dissension exists and has resulted in a deadlock precluding the successful and profitable conduct of the corporation's affairs."[62]

Conclusion

The addition of internal dissension as separate ground for dissolution clearly was meant to expand the availability of the dissolution remedy. Because every corporate dissolution case comes with unique facts, however, any attempt by the Legislature or the courts to set hard-and-fast dissolution criteria is doomed to failure.

Cases decided under the internal dissension statute exhibit something of a split personality, depending on whether the court views the corporation, successful or not, as more akin to a partnership terminable at will, or as an entity distinct from its owners, to be maintained if financially viable notwithstanding internecine warfare. Arguably, this duality is inherent in the statute's requirement that the petitioner establish both the existence of internal dissension and that the factions are so divided that dissolution would be beneficial to the shareholders. In other words, the statute can be read such that the cessation of shareholder hostilities itself is an adequate benefit of dissolution, or it can be read to require some other benefit (*i.e.*, financial) that may be hard to show when the business is otherwise viable and making money.

The best insurance against the uncertainty of business divorce is a shareholders' agreement with reasonable buy-sell provisions. Other techniques include arbitration agreements, voting trusts and appointment of provisional directors.[63] Clients starting new business ventures with co-owners should be strongly encouraged to make the up-front investment in these types of consensual arrangements to minimize the later risk of a judicially imposed death – or life – sentence for their corporation.

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1. *In re Fazio Realty Corp.*, 781 N.Y.S.2d 118 (2d Dep't 2004).
2. *Id.* at 119.
3. *See, e.g.*, *In re Parveen*, 259 A.D.2d 389, 687 N.Y.S.2d 90 (1st Dep't 1999) (there can be no deadlock where contending factions never attempted to elect directors).
4. For a comprehensive review of the law governing shareholder oppression, dissolution and valuation proceedings under BCL §§ 1104-a and 1118, see the author's two-part article in the May/June and July/August 1999 NY State Bar Journal, Vol. 71, Nos. 5 and 6.

5. *In re Cristo Bros.*, 64 N.Y.2d 975, 489 N.Y.S.2d 35 (1985).
6. As noted by the Court of Appeals in *Cristo*, *id.*, the legislative history of BCL § 1118 contains no indication why it accorded buy-out rights for dissolution petitions under BCL § 1104-a but not under BCL § 1104.
7. *See In re Clemente Bros.*, 19 A.D.2d 568, 239 N.Y.S.2d 703 (3d Dep't 1963) (reinstating bad faith affirmative defense in dissolution proceeding).
8. For a discussion of the early history of dissolution legislation, see *Hitch v. Hawley*, 132 N.Y. 212 (1892). *Verplanck v. Mercantile Ins. Co.*, 1 Edw. Ch. 84, 6 N.Y. Ch. Ann. 68 (1831), is one of the earliest cases holding that New York courts have no common law authority to dissolve corporations and that statutory remedies are exclusive.
9. *Hitch*, 132 N.Y. at 217.
10. *Id.* at 218.
11. The GCL was repealed by 1973 N.Y. Laws ch. 451, § 2. See discussion *infra* at "Adoption of Internal Dissension as Ground for Dissolution."
12. *See In re Superb Diamond Cutting Corp.*, 183 Misc. 876, 878, 51 N.Y.S.2d 651 (Sup. Ct., N.Y. Co. 1944).
13. The text of GCL §§ 103 and 117 is set forth in *In re Cantelmo*, 275 A.D. 231, 232, 88 N.Y.S.2d 604 (1st Dep't 1949).
14. *Cantelmo*, 275 A.D.2d 231.
15. *Id.* at 233.
16. *Id.* at 235.
17. 128 N.Y.S.2d 81 (Sup. Ct., N.Y. Co. 1953).
18. The *Bankhalter* petitioner was a one-third shareholder whose consent was required for any action by the board or shareholders. Former GCL § 103 and current BCL § 1104(b) both permit shareholders with less than 50% of shares to seek dissolution when the certificate of incorporation has super-majority voting requirements for board action or elections. Unlike its predecessor, BCL § 1104(b) sets a one-third minimum.
19. *Bankhalter*, 128 N.Y.S.2d at 83, 85.
20. 307 N.Y. 1 (1954).
21. 307 N.Y. 407 (1954).
22. *Radom & Neidorff*, 307 N.Y. at 6–7.
23. *Id.* at 7.
24. *Id.* at 6, 7.
25. *Id.* at 7 (citations omitted) (quoting *Hitch v. Hawley*, 132 N.Y. 212, 221 (1892); GCL § 117).
26. *In re Seamerlin Operating Co.*, 307 N.Y. 407, 413–14 (1954).
27. *Id.* at 417 (citations omitted).
28. 15 Misc. 2d 713, 182 N.Y.S.2d 459 (Sup. Ct., Erie Co.), *modified on other grounds*, 9 A.D.2d 861, 193 N.Y.S.2d 34 (4th Dep't 1959).
29. *Id.* at 715 (quoting N.Y.S. Law Review Comm'n and New York Leg. Doc. No. 65K [1948] p. 389 *et seq.*).
30. *Id.* at 715–16.
31. *Id.* at 716.
32. *Id.*
33. McKinney's Cons. Laws of N.Y., Legislative Studies and Reports, BCL § 1104 (2003).
34. BCL § 1111(b)(2).
35. BCL § 1111(b)(3).
36. "The additional criterion embodied in Section 117 of the [GCL] that the dissolution be 'not injurious to the public' has been omitted; the revisers felt that in the types of corporations subject to the BCL, the interests of the shareholders should override the public interest in the continuance of the business." 4 White, New York Corporations § 1111.01[2], text accompanying n.10.
37. 105 A.D.2d 339, 484 N.Y.S.2d 541 (1st Dep't 1985).
38. *Id.* at 343.
39. *Id.* at 345–46.
40. 225 A.D.2d 775, 640 N.Y.S.2d 569 (2d Dep't 1996).
41. *Id.* at 775–76.
42. 228 A.D.2d 187, 188, 643 N.Y.S.2d 94 (1st Dep't 1996).
43. *Id.* at 188.
44. *Id.* at 189.
45. *Id.*
46. 259 A.D.2d 389, 687 N.Y.S.2d 90 (1st Dep't 1999).
47. *Id.* at 391.
48. 22 A.D.2d 390, 256 N.Y.S.2d 210 (4th Dep't 1965).
49. *Id.* at 391–92.
50. *Id.* at 392.
51. 55 Misc. 2d 888, 286 N.Y.S.2d 580 (Sup. Ct., N.Y. Co. 1967).
52. *Id.* at 892.
53. *Id.*
54. 32 A.D.2d 279, 301 N.Y.S.2d 839 (1st Dep't 1969).
55. *Id.* at 281.
56. *Id.*
57. 98 A.D.2d 413, 469 N.Y.S.2d 931 (1st Dep't 1984).
58. *Id.* at 415.
59. *Id.* at 421.
60. *Id.*
61. 200 A.D.2d 670, 607 N.Y.S.2d 52 (2d Dep't 1994).
62. *Id.* at 671.
63. 4 White, New York Corporations § 1104.05.