

Business Divorce—Is Judicial Dissolution a Practical Solution?



By Michael J. Duffy, Esq.

Not every relationship is meant to last forever. Differences among business owners of closely-held hospitality and retail companies and corporations sometimes make a “business divorce” inevitable. In some cases, mechanisms for resolving a break-up already have been designed and hard-wired into the organizations’ governing documents. Where no such provisions exist and the parties cannot reach agreement on the process going forward, however, one or more parties may seek a “judicial dissolution”. Although these statutory remedies exist for certain desperate circumstances, the risks, unpredictability of results, and costs of such proceedings often make judicial dissolution impractical. Organizations finding themselves with ownership at loggerheads are well-advised to sharpen their pencils and reach a negotiated solution where one of the owners buys the other(s) out or where the company is sold to a third party and the proceeds are divided.

Proceeding with judicial dissolution means putting the decision to dissolve the entity in the hands of the court and embracing an uncertain outcome. Under the Massachusetts statute governing corporations, a petition for dissolution must (a) be made by shareholders holding at least 40% of the voting shares, and (b) must demonstrate there is a deadlock in management, the parties cannot break the deadlock, and irreparable harm to the corporation is being threatened or suffered. Under the statute governing limited liability companies, the requirements are somewhat different. A petitioner must show that “it is not reasonably practicable to carry on its business in conformity with the certificate of organization or the operating agreement.” In real terms, the statutory requirements for obtaining a judicial dissolution are not easily proved, especially in a contested litigation process.

In addition, Massachusetts courts have been reluctant to order judicial dissolution except in extremely rare situations. The tendency is for courts to encourage the litigants, expressly or implicitly, to seek other mechanisms for resolving their disputes. Even in a case where a court found that deadlocks in management of a two-person corporation “may well be warranted,” the court delayed entering a dissolution order “to give the parties still further time to attempt a less draconian resolution.” The message often delivered is that the business owners, even if bitterly opposed, should find their own economic solution.

Seeking judicial dissolution may also lead to unintended and unwanted consequences. Under the current interpretations of the applicable statutes, the court is empowered to require a sale of the business to a third party. The court is not permitted to force a sale of the interest of one owner to another. Judicial dissolution may mean losing the family business or selling a beloved restaurant or shop to new owners. Additionally, where there is no agreement on a valuation or sale price for the business, the court may apply a different valuation standard than the parties envision. Further, the costs incurred in litigating the issues surrounding a judicial dissolution, which may be considerable, should realistically be factored into the analysis. Accordingly, at the end of the process, the effort to get out a bad situation may simply have the parties fighting for a solution that could be equally bad or worse financially.

The law provides judicial dissolution as a backstop for companies that are stymied and dying on the vine due to irresolvable disputes in management. While this remedy exists, it is not easily accessed and courts have been reluctant to order it even in arguably appropriate cases. Litigating a judicial dissolution case all the way through to an order, which may include a trial, is an extremely costly pursuit. Business owners who find themselves in the horns of even the most acrimonious and bitter intra-company struggles are well advised to concentrate their resources on negotiating a solution rather than handing the baby over to King Solomon.

**Michael is an associate of Ruberto, Israel & Weiner and member of the firm's Litigation; Construction Law; and Retail, Food & Hospitality Groups.
Michael can be reached at mjd@riw.com.**