

ALERT

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**NEW YORK STATE APPELLATE COURT PROVIDES
LONG-AWAITED GUIDANCE ON JUDICIAL DISSOLUTIONS
OF LIMITED LIABILITY COMPANIES, BUT LEAVES MANY
QUESTIONS UNRESOLVED**

Since its adoption in 1994, limited liability companies and attorneys alike have faced the difficult task of interpreting the judicial dissolution provisions of the New York State Limited Liability Company Law (the “LLCL”). In particular, Section 702 provides that a New York limited liability company may be dissolved upon the application of one of its members if “it is not reasonably practicable to carry on the business [of the company] in conformity with the articles of organization or operating agreement.” However, the statute does not define what “not reasonably practicable” means, and many limited liability companies either do not have operating agreements or such agreements do not sufficiently address the concepts of dissolution and dispute resolution (among other things).

Recently, the Appellate Division of the New York State Supreme Court (Second Department) issued an opinion partially addressing the definition of “not reasonably practicable,” the first such interpretation of Section 702 of its kind. The court held that “for dissolution of a limited liability company, the petitioning member must establish, in context of the terms of the operating agreement, 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.”¹ While this decision provided the first step to bringing clarity to the situation, it is far from providing an objective guideline. Furthermore, the court clearly stated that it will look at each company’s operating agreement when making these determinations.

According to the facts set forth in the case, the operating agreement of 1545 Ocean Avenue LLC (the “Company”) empowered each of the Company’s two managers to act autonomously in furtherance of the business of the Company. However, the agreement was silent as to the issue of disputes between the managers. After the Company’s formation, several disagreements occurred between the two managers with respect

¹ *In re 1545 Ocean Avenue, LLC.*

ALERT

Moritt Hock Hamroff & Horowitz LLP is a broad based commercial law firm with 42 lawyers and a staff of paralegals. The firm has experience in commercial foreclosure; construction law; corporate, securities & financial services; creditors' rights & bankruptcy; employment & labor law; equipment & vehicle leasing; healthcare law; intellectual property, unfair competition & licensing; litigation; marketing & advertising law; not-for-profit law; real estate law; tax; and trusts & estates.

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to the management of the Company and the work performed by one of them on behalf of the Company. When tensions escalated, one of the managers applied for judicial dissolutions based upon a deadlock between the Company's managers. The court determined that, despite the conflicts, the managers were able to promote the stated business purpose of the entity and that continuing the entity was financially feasible. Accordingly, the court found that there was no proper basis for dissolution. What the Company's operating agreement says, and what it does not say, particularly regarding dissolution and dispute resolution among the members, played a pivotal role in the court's analysis.

While this decision offers some much-needed guidance on judicial dissolution, it is far from definitive with respect to all limited liability companies. Furthermore, the decision illustrates the importance of having a carefully constructed and thorough operating agreement, since the court clearly determined that wrongful acts by a manager alone do not provide for judicial dissolution unless there are provisions in the operating agreement to that effect. If the managers of the Company had taken the time to prepare a detailed operating agreement which described the procedure in the event of manager deadlocks, there might not have been a need to go through with the judicial dissolution application or any other litigation.

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If you own, or manage, a limited liability company and you have any questions with respect to the company's operating agreement, please feel free to contact us. Our corporate department can explain each provision, the ramifications of the provisions and the potential consequences of certain omissions. Furthermore, we can assist you with revising existing operating agreements as well as preparing them upon the formation of the limited liability company. As illustrated by this recent case, the failure to take the time to prepare, review and/or revise your operating agreement now (particularly regarding the procedure for dispute resolution and how and when dissolution can take place) can lead to lengthy, expensive and unpredictable litigation.