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Strife in business partnership sometimes necessitates a dissolution


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As Billy Joel sang in "Scenes from an Italian Restaurant," "they started to fight when the money got tight, and they just didn't count on the tears." The piano man was singing about marriage and divorce, but he just as easily could have been describing what many attorneys refer to as "business divorce." Closely held businesses, those owned by a handful of individuals, often members of the same family, do not always stand the test of time. When disagreements, resentment and mistrust arise, the owners retreat to their corners and call their lawyers. The remedies available to aggrieved owners who can no longer do business with one another vary from company to company based on a number of factors both legal and economic.

One of the largest business divorces in recent times was that involving the two principal owners of AriZona Iced Tea. The company, or rather series of companies with no corporate parent, was founded by John Ferolito and Don Vultaggio, two Brooklyn natives who turned a tiny ready-to-drink tea company into a multibillion dollar business. The genius of AriZona was its decision to print its price right on the can. It began selling 24 ounce "tallboy" cans of tea for the same price as smaller bottles of competitors' products, and with 99¢ on the can the small neighborhood grocery stores where the brand got its start could not raise the price. AriZona became the tea of choice for value shoppers. The AriZona fight brewed slowly, first with Vultaggio moving the headquarters closer to his home and further from Ferolito's, then with Vultaggio refusing to communicate with Ferolito and instead relying on the counsel of professionals Ferolito did not trust. Rather than address problems head on, Ferolito stepped back from day-to-day operations, leaving Vultaggio and others to operate their companies. As AriZona became more profitable, it began attracting suitors, with potential buyers offering as much as $4 billion for the brand. Ferolito wanted to sell, Vultaggio did not. Because both men, together with their families, each held equal 50 percent shares, neither could sell a controlling interest. They were also parties to a shareholders' agreement that precluded them from selling to anyone except members of their families. In the end, unable to establish that the shareholders' agreement was unenforceable, Ferolito sought to dissolve the company.

After many years of litigation, antics including sending armed guards to company headquarters to review books and records, and untold legal fees paid to the world's most prestigious law firms, a court ordered Vultaggio to buy out Ferolito for $1 billion. The owners reached a private settlement thereafter. Vultaggio was able to fund the buyout by leveraging his interest in the company with a loan and by releasing cash that the company opted not to distribute to its owners while the fight was ongoing.

Not every corporate dispute is the same, and the tools available to oppressed owners like Ferolito vary based on corporate form, ownership percentage and economics. The tool used in AriZona by Ferolito to recover some value from his company, a lawsuit for dissolution, is most often a tool of last resort for shareholders who have been squeezed out of the management of companies they own. Under New York's Business Corporation Law, shareholders holding at least 50 percent of the ownership interests in a company can sue to bring that company to an end through involuntary dissolution. Shareholders with smaller shares, between 20 percent and 49 percent, can also sue for dissolution only if they can show that the owners of the majority interest in the company have breached fiduciary duties, committed waste or otherwise oppressed them, but the law provides a means for companies to buy these minority shareholders out and continue the business at a price set by a referee appointed by the court. Shareholders with an interest of less than 20 percent lack standing to cause dissolution.

Involuntarily dissolving limited liability companies is far more challenging, particularly for minority owners. The standard to dissolve an LLC in New York is that it is "not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement." This is a high burden. However, minority members of LLCs often have other options under the terms of their operating agreements. Operating agreements may contain buy/sell agreements and other provisions for the reimbursement of withdrawn members. Some even have provisions for the expulsion of members. Nonetheless, depending on the language of a particular operating agreement, the economics of withdrawing may not be ideal. Close attention should be paid by those taking a minority interest in an LLC regarding their ability to get out of a company if relationships sour, and the right to leave must be balanced against the rights of the remaining members to continue the business without undue expense.

More often than not, the goal of a dissolution action is not to actually end the company. If a court actually orders dissolution, a company must wind up its affairs, pay its creditors, sell its assets and distribute the proceeds to owners. If a business has a going concern value that is greater than its liquidation value, dissolution is not the way to maximize value. Instead, a sale of the company, or the departing shareholder's interest, either to a current owner or a third party, is advisable. Dissolution may merely force a recalcitrant owner's hand.

Economic factors may weigh against seeking dissolution, even to force a buyout. If a company is insolvent and shareholders have guaranteed corporate debt, winding up and liquidation could result in a shortfall with creditors looking to individual guarantees. Even if a company is not insolvent, the commencement of dissolution proceedings is frequently an event of default under loan documents, and while creditors will usually give companies time to cure a dissolution action default by obtaining dismissal of the litigation or settling it within a specified cure period, the threat of loan default could depress the value a disgruntled exiting shareholder could recover, particularly if a company and its remaining owners cannot leverage their assets to fund a buyout.

Business owners who find themselves being squeezed out of their companies have options, and competent legal counsel can help assess the landscape and guide them through the process.

Curtis A. Johnson is a commercial litigator at Bond, Schoeneck & King, PLLC and was a member of John Ferolito's legal team at Milbank, Tweed, Hadley & McCloy LLP early in the litigation process. The information contained in this article regarding the AriZona dispute is based on publicly filed court documents.