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New York Business Corporation Law 1104-a Dissolution Actions: A Last Resort for Shareholders

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Under New York Business Corporation Law (BCL) 1104-a, shareholders possess a powerful tool that allows them to seek the dissolution of a corporation when their interests or the interests of the corporation are at stake. While dissolution may be necessary in extreme cases of internal conflict, shareholders should understand that 1104-a dissolution actions are generally disfavored in New York, and should only be considered as a measure of last resort. This article delves into the reasons why shareholders should explore all other options before taking this significant step, and provides shareholders with viable alternatives to dissolution.

New York's BCL 1104-a was created to address specific situations where a corporation's internal disputes, mismanagement, or other critical issues have reached an impasse, thereby threatening the corporation's ability to function effectively. The statute provides a legal remedy to shareholders who find themselves in situations such as a deadlock among directors, irreconcilable differences among shareholders, an inability to elect a board as required by the corporate

bylaws or allegations of illegal, fraudulent or oppressive actions by those in control.

When minority shareholders of a closely held corporation (at least 20% of the voting shares) move forward with an 1104-a action seeking judicial dissolution, the majority shareholder and/or the corporation may elect to purchase the minority interests pursuant to BCL §1118. Under §1118, the court may order stock valuations (setting the share price when the majority owner elects to purchase) and may provide for a surcharge on the directors or those in control of the corporation upon a finding of willful or reckless dissipation or transfer of assets or

corporate property without just or adequate compensation.

This "right of election" is only available if the petition is brought under 1104-a, and it is not available if dissolution is sought under BCL §1104, which requires 50% of the voting shares in order to bring a petition seeking judicial dissolution.

Dissolution, however, is a drastic remedy that can have profound implications for the corporation, its shareholders, employees, and other stakeholders. Thus, courts have held that it should be viewed as a last resort to be considered only when other options for resolving internal corporate conflicts have been exhausted.

For example, the Erie County Supreme Court (J. Walker) recently dismissed a shareholders' Petition for Dissolution under 1104-a. *Kavanaugh v. Consumers Beverages, et al.,* 806587/2022. Because there were several other actions pending between the parties, the court found that the petitioning shareholders had adequate remedies available other than dissolution.

In its decision from the bench, the court went on to explain that "dissolution [. . .] under the common law or statute is disfavored in New York, especially when there are other ways to handle the grievances and/or differences or legal issues." *Kavanaugh v. Consumers Beverages, et al.,* 806587/2022.

As a practical matter, the following are a few key issues that should be considered in deciding whether to proceed with a dissolution under 1104-a:

• **Asset Liquidation**: Upon dissolution, the corporation's assets are typically sold, and the proceeds are distributed among the shareholders according to their ownership stakes. This liquidation process can involve the sale of real estate, equipment, investments, and other assets owned by the corporation.

• **Tax Consequences**: The distribution of assets and the receipt of funds may have tax implications for shareholders. Depending on the specific circumstances, shareholders may incur capital gains tax liabilities.

• **Job Losses**: The dissolution of a corporation often leads to job losses. Employees who rely on the corporation for their livelihood may find themselves unemployed as a result of the dissolution.

• **Disruption of Business Relationships**: The dissolution can disrupt relationships with suppliers, customers, and other business partners. These parties may have to find new partners or vendors, which can be disruptive and potentially costly.

• **Legal Costs**: Legal fees associated with the dissolution process can be substantial, and will be borne by the shareholders, further reducing the assets available for distribution.

Accordingly, before deciding to initiate a BCL §1104-a dissolution action, shareholders should consider the following alternatives:

• **Mediation and Negotiation**: One of the primary alternatives to dissolution is mediation and negotiation. These processes provide a structured platform for shareholders and other stakeholders to engage in open, facilitated discussions to reach a resolution. A skilled mediator can help parties find common ground and reach mutually acceptable agreements. Mediation and negotiation offer several benefits, including confidentiality, cost-effectiveness and the preservation of business relationships.

• **Arbitration**: Some corporate bylaws or shareholder agreements may stipulate the use of arbitration to resolve disputes. Arbitration provides a more formal process than mediation, with parties presenting their cases before a neutral arbitrator, who then renders a binding decision. Arbitration can provide a more private and expedient means of settling conflicts.

• **Amending Bylaws or Operating Agreements**: Shareholders can consider revising the corporation's bylaws or operating agreements to address the specific issues causing conflict. This may include changing voting requirements, redefining corporate governance procedures or specifying dispute resolution mechanisms.

• **Appointment of a Receiver:** In certain circumstances, it may be possible to appoint a receiver to oversee the corporation's operations temporarily while disputes are being resolved. A receiver can help maintain business continuity while internal issues are addressed.

• **Buy-Sell Agreements**: Shareholders may have buy-sell agreements in place that dictate how one shareholder can exit the company, either voluntarily or under specific conditions. These agreements can offer a structured way to resolve disputes.

By considering these alternatives, shareholders can potentially preserve the corporation and its assets while resolving internal issues more amicably.

New York BCL §1104-a dissolution actions should be viewed as a last resort. Shareholders and corporate stakeholders should explore alternative means of resolving disputes and conflicts within the corporation before resorting to dissolution. Legal processes, such as mediation, negotiation and arbitration, as well as amendments to corporate governance documents, can often provide more amicable and efficient solutions.

The decision to pursue dissolution should be made after careful consideration of the potential consequences and only when all other options have been exhausted. By understanding the gravity of this legal remedy, shareholders can act in the best interests of the corporation and all those who depend on its continued operation.

However, should it be determined that dissolution is the only viable or available remedy, shareholders should seek the advice of experienced legal counsel.

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