Delaware’s Answer to Management Deadlock in the Limited Liability Company: Judicial Dissolution

Meghan Gruebner*

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I. INTRODUCTION

The combination of corporate and partnership forms in a limited liability company (LLC) has appealed to many entrepreneurs and has caused the LLC form not only to emerge as an alternative business governance structure, but also to explode as a favored corporate regime.1 Delaware adopted its first LLC statute in 1992, and over 150,000

* J.D. Candidate, University of Iowa College of Law, 2007; B.A., University of Michigan-Ann Arbor, 2004. I would like to thank Professor Ethan Stone for setting and keeping me on the right track and to my loving parents for their continuing support.

1 See Larry E. Ribstein, The Emergence of the Limited Liability Company, 51 BUS. LAW. 1 (1995) (claiming that thousands of LLCs have been formed across the country at a greater rate than limited partnerships); see also KAREN S. WALKER ET AL., LLCs FOR START-UPS & GROWING COMPANIES 19 (2001) (evaluating the success of LLCs in Delaware).
Delaware LLCs formed in the following decade. By 1996, tens of thousands of LLCs had been formed and all fifty-one United States jurisdictions had adopted LLC statutes.

LLC statutes have been enacted and amended quite rapidly since the adoption of the first LLC statute. The LLC has evolved into more of a distinct form and less of a hodgepodge of existing corporate and limited partnership rules. However, the LLC is still a relatively new governance regime when compared to the partnership structure, which existed as a common law form of organization long before the first limited partnership statute had been adopted in 1822.

There is currently very little case law interpreting LLC statutes or agreements, but the entity’s rising popularity will cause litigation involving LLC agreements and statutes to increasingly appear before the courts. It is uncertain whether or not a unique LLC jurisprudence will develop, but courts will undeniably look to existing forms—general or limited partnerships or corporations—and apply the rationale and principles behind them to disputes involving LLCs. Indeed, the Delaware Limited Liability Company Act draws on many of the provisions of Delaware’s well-accepted limited partnership statute, the Delaware Revised Uniform Limited Partnership Act, and the Delaware General Corporation Law.

This Note will explore an unsettled area of law for LLCs—the possibility of judicial dissolution. Part II of this Note will discuss the purposes behind the provisions of the Delaware Limited Liability Company Act and introduce the focus of this Note, the contentious case of Haley v. Talcott. Part III will discuss the corporate deadlock problem faced by the parties in Haley and try to explain the basis for the court’s decision. Part IV will discuss what the case suggests for future Delaware LLCs and Delaware courts facing disputes involving LLC judicial dissolution.

II. BACKGROUND

A. Delaware’s Commitment to Freedom of Contract for Limited Liability Companies

In forming an LLC, members must comply with statutory requirements and should

2. Larry E. Ribstein, Unincorporated Business Entities 288 (1996). The prevalence of LLCs in the decade following the Delaware Limited Liability Company Act seems even more exceptional in light of the total number of Delaware corporations—325,000—at that time. Id.

3. Id. The LLC became popular in 1988 due to Revenue Ruling 88-76 in which the Internal Revenue Service (IRS) classified a Wyoming LLC as a partnership for tax purposes. Id. at 286; see also Rev. Rul. 88-76, 1988-2 C.B. 361.

4. Ribstein, supra note 2, at 286.

5. Walker et al., supra note 1, at 19 (stating that courts will analogize LLCs to other corporate forms because LLC statutes and agreements use language similar to that used by partnerships and corporations); see, e.g., Haley v. Talcott, 864 A.2d 86 (Del. Ch. 2004) (analogizing and applying a provision of the Delaware General Corporate Law in resolving an LLC dispute); In re Silver Leaf, L.L.C., No. 20611, 2005 Del. Ch. LEXIS 119 (Aug. 18, 2005) (analogizing and applying a provision of the Delaware Revised Uniform Limited Partnership Act in deciding an LLC dispute).

6. See supra note 5 and accompanying text.

7. 864 A.2d 86 (Del. Ch. 2004).

8. See Delaware Limited Liability Company Act, DEL. CODE ANN. tit. 6, § 18-206 (2005), for an example of a statutory requirement involving the filing of a certificate with the Secretary of State or an equivalent agency.
draft an operating agreement. The operating agreement is similar to the partnership agreement of a general partnership and stipulates the governing rules of the particular firm. Inconsistent provisions in LLC operating agreements displace conflicting statutes if the statutes supply default, rather than mandatory, controls.

Most LLC statutes have few mandatory provisions, giving the parties great freedom to construct their governing rules. Delaware’s statute is the most permissive—“It is the policy of [the Delaware Limited Liability Company Act] to give maximum effect to the principle of freedom of contract and to the enforceability of [Delaware] limited liability company agreements.” The Delaware Limited Liability Company Act’s basic attitude is to give LLC members broad discretion in determining their LLC governing structure and rules.

B. The Court’s Right to Dissolve the LLC

All LLCs dissolve (terminate) upon certain events enumerated in the particular state’s LLC statute. One of the enumerated events of dissolution in Delaware says that the Court of Chancery may dissolve an LLC if one of its members claims that it is not “reasonably practicable to carry on the business” in accordance with the purpose of the LLC agreement. The key word in that section is “may”—which means that the court is not compelled to decree dissolution of an LLC, but may exercise discretion to do so. As mentioned above, because litigation involving LLC disputes is sparse, courts are likely to look at other existing forms of corporate governance when determining whether to grant dissolution. Parts II.B.1 and II.B.2 explore this idea.

1. Analogies to Limited Partnerships

Courts may look to the provisions of partnership statutes and the case law interpreting them when deciding matters involving LLC disputes. For instance, the Delaware Revised Uniform Limited Partnership Act (DRULPA) includes an analogous provision to section 18-802 of the Delaware Limited Liability Company Act—section 17-802—that allows the Court of Chancery to dissolve a limited partnership when “it is not reasonably practicable to carry on the business in conformity with the partnership agreement.” The Delaware Court of Chancery rarely exercises its discretion to dissolve a partnership under section 17-802, generally reasoning that its power to order dissolution

9. Ribstein, supra note 2, at 289.
11. Ribstein, supra note 2, at 290.
13. Walker et al., supra note 1, at 28.
14. See, e.g., Delaware Limited Liability Company Act, Del. Code Ann. tit. 6, § 18-802 (2005) (an LLC will be dissolved: (1) when the LLC operating agreement specifies a certain time for dissolution; (2) when the LLC operating agreement specifies a certain event for dissolution; (3) when the members consent in writing, unless otherwise provided; (4) when all members cease to exist, unless the personal representative of the last remaining member gives written consent to continue the LLC and is admitted to the LLC as a member within 90 days, unless otherwise provided; and (5) by court order).
15. Id.
16. Id. § 17-802.
is “narrow and limited.” In assessing whether judicial dissolution pursuant to section 17-802 is appropriate, the Court of Chancery must determine the business purpose of the limited partnership and the general partners’ continuing ability to realize that purpose while operating in conformity with the partnership agreement.

For example, in two cases involving limited partnerships, *Cincinnati Bell Cellular Systems Co. v. Ameritech Mobile Phone Service, Inc.* and *Red Sail Easter Ltd. Partners v. Radio City Music Hall Productions, Inc.*, the Delaware Court of Chancery refused to grant judicial dissolution. In the first case, a regional telephone company entered into a limited partnership agreement for the provision of cellular mobile services and later sought judicial dissolution, claiming that the partnership was less profitable than it could have been. The court held that, although the partnership’s returns were not as great as its competitors, it was meeting its stated purpose of providing cellular services; therefore, judicial dissolution would be improper.

The second case involved a limited partnership whose business purpose was to finance the production of the Easter Show at Radio City Music Hall. The limited partners filed for judicial dissolution when their working relationship with the general partner deteriorated. The court denied the limited partners’ request for judicial dissolution, reasoning that the partnership was successfully carrying on the business of presenting the Easter Show in New York and of exploiting the licensed right to present road shows of the Easter Show as contemplated by the partnership agreement.

Conversely, in another case involving a limited partnership, *PC Tower Center, Inc. v. Tower Center Development Associates Ltd. Partnership*, the Delaware Chancery Court exercised its discretion and found dissolution necessary under section 17-802. The limited partnership was formed to acquire, own, and operate a mercantile center. When it was obvious to the general partner that the property was not operating at an economic gain (and was not expected to do so during the term of the net lease), he sought judicial dissolution, claiming that it was no longer reasonably practicable to carry on the business of the limited partnership at a loss.

The court elaborated on the standard of dissolution pursuant to section 17-802. It stated that the standard set forth by the legislature—“whenever it is not reasonably practicable to carry on the business”—was meant precisely to mean reasonable

17. *Walker et al., supra* note 1, at 19.
22. *Id.* at *18. The Partnership Agreement indicated that the partnership’s business purpose was “to fund, establish, and provide [c]ellular [s]ervice.” *Id.* at *9.
24. *Id.*
26. *Id.* At *16.
27. *Id.* at *4.
28. *Id.* at *13, 14.
practicability, not impossibility. Consequently, the court held that, because the partnership could not service its debt, it was no longer “reasonably practicable”—although possible—to carry on the purpose of the partnership agreement, namely, to use the property “for profit and as an investment.”

The petitioner also set forth two more reasons, which are similar to the facts of Haley, to explain why the partnership could no longer carry on its business purpose in a reasonably practicable manner. First, the petitioner was in a position of irreconcilable conflict with the other partners, to whom he owed a fiduciary duty. Second, the partners were in a deadlock—incapable of agreeing on a manner in which to enforce the rights of the partnership. Although the petitioner presented these two reasons, the court did not expressly use them as a basis for its decision to dissolve the limited partnership.

2. Analogies to Corporations

Similarly, Delaware courts often resolve disputes involving LLCs by looking to the Delaware General Corporation Law (DGCL) and its related case law. For example, DGCL section 273 provides for judicial dissolution of a joint venture corporation consisting of two stockholders. The plaintiff in Haley analogized its situation to that of a joint venture consisting of two stockholders, subsequently arguing that the court should have paralleled its analysis of section 18-802 of the Limited Liability Company Act to that of section 273 of the DGCL. The purpose of section 273 is to provide a speedy mechanism for dissolving a joint-venture corporation and to supervise the distribution of assets when two equal shareholders are in a voting deadlock.

Take, for example, Arthur Treacher’s Fish & Chips, Inc., a case involving the issue of judicial dissolution under DGCL section 273. In this case, petitioner and respondent each owned fifty percent of a joint venture corporation—Arthur Treacher’s Fish & Chips restaurants. The court laid out the requirements for judicial dissolution under section 273 as follows: 1) the corporation at issue must have only two stockholders, each holding fifty percent of its stock; 2) the two stockholders must be engaged in the prosecution of a joint venture; and 3) they must be unable to agree upon the desirability of discontinuing the business and disposing of the business’s assets.

In Arthur Treacher’s Fish & Chips, Inc., the stockholders disagreed on whether or not to continue the business. The petitioner stockholder wished to dissolve the joint venture,

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29. Id. at *16.
30. Id. According to the partnership agreement, the express business purpose was “to invest in, hold, own, operate, maintain, improve, develop, sell, exchange, lease . . . , and otherwise use the Project, . . . , for profit and as an investment.” PC Tower Ctr., 1989 Del. Ch. LEXIS 72, at *16.
31. Id. at *14.
32. Id.
34. See discussion infra Part III.B.1.
36. 386 A.3d 1162.
37. Id. at 1163.
38. Id. at 1163 n.1; see also DEL. CODE ANN. tit. 8, § 273 (2005).
while the respondent stockholder wished to buy out the dissolving stockholder's assets and continue the business.  

Like section 18-802 of the Limited Liability Company Act, section 273 of the DGCL authorizes the Court of Chancery to order dissolution if the requirements of the provision are met, but does not command it to do so. In considering whether or not to order dissolution under section 273, a court of equity is duty-bound to protect the interests of stockholders when they are threatened. For instance, in English Seafood, Inc., a case involving a petition for judicial dissolution of a corporate entity by one of the two co-owners, it was equitable for the court to order dissolution because the alleged deadlock between the shareholders would have depleted the dissolving owner's investment.

Further, the court will consider the parties' intent to continue or discontinue the enterprise at the time of formation of the corporate entity, which may be evidenced by a negotiated exit mechanism. In Delaware Bay Surgical Services, a shareholder petitioned for dissolution after the shareholders' relationship deteriorated. The court denied the petition because it found that the corporation was not acting as a joint venture. In dictum, however, the court declared that if section 273 had applied, it probably would have denied the petition, because the parties' intent was clear from the Shareholder's Agreement, which contained a formula for the repurchase of the complaining member's fifty percent interest. The parties had intended that the respondent, who had owned the corporation before admitting the petitioner, would retain the business and buy out the petitioner's interest if the two became unable to work with one another.

C. Haley v. Talcott and Judicial Dissolution

The only opinion in which the Delaware Court of Chancery has offered an in-depth

40. See Delaware General Corporation Law, Del. Code Ann. tit. 8, § 273(b) (2005) (stating "the Court of Chancery may dissolve such corporation and may . . . administer and wind up its affairs"); see also Arthur Treacher’s Fish & Chips, 386 A.2d at 1166 (holding that the legislature’s use of the word “may” undoubtedly conveys that dissolution is not intended to be granted automatically upon the filing of a petition for dissolution, but rather, the granting is to be discretionary); Fulk v. Wash. Serv. Assocs. Inc., No. 17747-NC, 2002 Del. Ch. LEXIS 78 (June 21, 2002) (holding that in a situation where the shareholders had failed to provide for an exit strategy, the Court of Chancery was not limited to ordering the dissolution of the joint venture corporation pursuant to section 273, but could adopt one fifty percent holder’s recommendation that one shareholder sell to the other, subject to various injunctive provisions imposed to protect the value of the underlying business).
41. Arthur Treacher’s Fish & Chips, 386 A.2d at 1167; see also In re English Seafood (USA) Inc., 743 F. Supp. 281, 286 (D. Del. 1990) (holding that section 273 creates a substantive equity right in stockholders to protect their investment in a corporation whose operations have become paralyzed by corporate deadlock; such a substantive equity right is enforceable and safeguarded by a federal court's equity powers).
43. Id. at 288.
45. Id.
46. Id. at *8-9.
47. Id. at *9.
48. Id.
discussion of the application of the LLC judicial dissolution statute is its recent decision of *Haley v. Talcott*. The suit involved a dispute between two LLC members, one manager (Haley) and one investor (Talcott), in which the manager member sought judicial dissolution of the company pursuant to section 18-802 of the Delaware Limited Liability Company Act. Originally, Talcott owned the restaurant and Haley’s rights were defined by a series of contracts. Haley’s Employment Contract positioned the business as a joint venture and limited Talcott’s ability to terminate Haley’s employment. The Real Estate Agreement gave Haley the right to participate in an option, held by Talcott, to buy the property on which the Redfin Grill was situated.

Within the first couple of years, the restaurant prospered under Haley’s management. By that time, Talcott had also received the start-up money with interest, and both parties were able to receive salaries. Shortly thereafter, Haley and Talcott formed an LLC in order to exercise Talcott’s option, subject to Haley’s participation right under the Real Estate Agreement. Each party took a fifty percent interest in the LLC. The LLC took out a bank loan to finance the purchase, and both parties personally guaranteed the mortgage. The restaurant continued to prosper and was able to cover the monthly mortgage payments owed by the LLC. Both Haley and Talcott seemed positioned to “reap the fruits of their labors.”

Alas, the personal relationship between the parties came to an end. Haley apparently believed that at some point he would receive a direct stock ownership interest in the restaurant. However, Talcott had no intentions of restructuring the relationship to provide Haley with such an interest. This disagreement subsequently led Talcott to write a letter to Haley, purporting to accept his resignation and forbidding him to enter the premises of the restaurant.

Haley responded with two letters. First, he stated that he did not resign and that Talcott terminated him without cause and in breach of the Employment Contract.
Second, he proposed that the LLC: (1) reject a new lease proposed by Talcott for the restaurant, (2) terminate the existing lease, and (3) sell the property. Unsurprisingly, Talcott rejected all of Haley’s proposals. Thus, Haley, a fifty percent shareholder, could not obtain the majority needed to enact any of them. Consequently, the status quo, which favored Talcott, continued.

Haley had only two potential alternatives to the status quo. He could avail himself of the exit mechanism provided in the LLC Agreement, or he could seek judicial dissolution. The exit provision of the LLC Agreement provided that if one member “quit” the company and gave written notice of such election, the remaining member could elect to purchase the departing member’s interest for fair market value and continue the business. The fair market value was to be determined upon the agreement of the parties, and if no such agreement could be reached, the fair market value was to be determined by three arbitrators. Once a fair market value was determined, the remaining member would pay it in cash, or over a term, to the departing member. Only if the remaining member refused to buy out the interest of the departing member would the company be liquidated.

Haley did not opt for the buy-out exit provision. Instead, he brought suit under section 18-802 of the Delaware Limited Liability Company Act, seeking judicial dissolution of the LLC. Haley claimed that it was not reasonably practicable for the LLC to carry on business in conformity with the LLC agreement when the members were in deadlock and the agreement called for both members to govern the operations of the LLC. Talcott argued that the LLC Agreement provided an alternative exit mechanism that allowed the LLC to continue to exist and urged the court to relegate Haley to that mechanism.

The court rejected Talcott’s argument and found that it was not reasonably practicable for the LLC to further its purpose in accordance with the LLC Agreement. Because the parties were in disagreement and each owned a fifty percent interest in the LLC, the deadlock and status quo could have continued indefinitely. The court reasoned that the exit mechanism did not provide a reasonable alternative for Haley, because Haley would still “be left liable for the debt of an entity over which he had no

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65. Id. At that time the property’s market value was appraised at $1.8 million. Id.
66. Id.
67. Id.
68. Haley, 864 A.2d at 91-92. Each member would get to choose one arbitrator, and the third was to be chosen by the first two arbitrators. The departing member would be obligated to pay for the reasonable expenses of the arbitration. Id. at 91.
69. Id. at 92. The fair market price could be paid only by term if it was secured by: (1) a note signed by the company and the remaining member, (2) a security agreement, and (3) a recorded Uniform Commercial Code (UCC) lien. Id.
70. Id.
71. Haley, 864 A.2d at 88.
72. Id. In other words, Talcott insisted that it was reasonably practicable to carry on the business’s purpose as provided for in the LLC Agreement, because the exit provision provided Haley with an equitable alternative—allowing him to receive fair market value for his share of the property—and provided for the continuance of the LLC. Id.
73. Id. at 98.
74. See infra Part III.
further control.” Furthermore, the exit mechanism did not mandate that the parties use it rather than a suit for dissolution upon a voting deadlock. As a result, the court ordered dissolution of the LLC, and ordered the parties to confer and submit a plan including the procedures to sell the property owned by the LLC on the open market. The court noted that either party could bid on the property.

The court addressed the application of section 18-802 as a matter of first impression. It is therefore worth analyzing how the court’s decision affects the way in which parties draft their LLC agreements and where it leaves the parties who wish to form an LLC. Part III addresses this analysis.

III. ANALYSIS: THE DEADLOCK PROBLEM

As discussed, Haley and Talcott were in deadlock. Any business decision or judgment required the consent and vote of both members, leaving the course of business unchanged if either voted down a proposal. Deadlock favored Talcott’s interests, since he benefited from the status quo. Haley and Talcott contracted to provide in their LLC agreement a mechanism for voluntary withdrawal.

The court noted that this detailed exit provision evidenced the level of thought and care put into the contract at the time of entity formation. Nonetheless, the court was not willing to rely on the presence of a specifically negotiated exit provision to establish the practicability of continuing the LLC. First, it noted that the exit provision did not expressly release Haley from his personal guaranty of the LLC’s mortgage. Second, the court argued that the exit provision did not purport to be an exclusive remedy. It did not require a dissatisfied member to break an impasse by exit rather than a suit for dissolution.

One might question whether or not the court should have overlooked these difficulties and forced Haley to exit via the contract provision. Parties can expect great freedom in drafting their LLC operating agreements and judicial deference to them, yet an LLC agreement is a contract that avails itself of a state-provided governance structure. Parties to an LLC agreement generally understand that the contract includes a certain amount of equitable court supervision of the governance structure, as distinct from legal enforcement of the benefit of the bargain. Upon closer look, the case does not seem to be a simple issue of forcing the parties to adhere to the contractual exit mechanism.

Perhaps the court’s holding was based on a recognition that lawyers cannot contract

75. Haley, 864 A.2d at 88.
76. Id. at 92.
77. Id. at 98. The court noted that, arguably, it was economically more efficient—absent an agreement between the parties forcing one to exit if he was dissatisfied with the status quo—to order dissolution of the LLC and allow the assets to go to the highest bidder. Id. at 97 n.35.
78. Id. at 97.
79. Haley, 864 A.2d at 92.
80. Id.
81. Id.
82. Id.
83. See, e.g., Willie Gary LLC v. James & Jackson LLC, No. CIV.A.1781, 2006 WL 75309, at *6 (Del. Ch. Jan. 10, 2006) (holding that its duty, in the first instance, was to look at the LLC agreement for words clearly and unmistakably indicating that the parties submitted the question of arbitrability to an arbitrator, which is typically left to the courts).
for every possibility and contingency. It would be too costly and inefficient to contract away every feasible contingency, and, moreover, parties are unable to foresee all possible events. In some unforeseen situations, courts may find it equitable to step in.

On the other hand, all parties understand the limits of contracting and enter into agreements assuming the risk that contingencies may result and make the contract’s terms unfavorable to them. In this case, the contingency entailed an unforeseen deadlock. The court could have found in this situation that Haley had, in fact, agreed to use the exit mechanism as the contractual solution for deadlock. But, it declined to do so. Parts III.A and III.B will analyze why the court ruled the way it did.

A. The Court’s Case-Specific Analysis

At first glance, it would appear that Haley was behaving opportunistically to avoid an unfavorable contractual provision for which he had assumed the risk. The LLC structure—which both parties agreed to with eyes wide open—allowed the status quo to continue upon deadlock. Since Haley was dissatisfied with the rightful—though unfavorable—situation, it would seem that he should have been the one to exit if unhappy.

Yet upon further inquiry, it seemed that Talcott was behaving opportunistically as well. The court held that the major flaw of the exit provision was that it still left Haley with the debt liability of the entity. If Talcott had wished, he could have allowed Haley to exit via the contractual provision and simultaneously relieved Haley of the debt liability, by either taking on the debt himself, or settling the debt with the bank. Talcott had ample opportunity to settle this matter before the court reached its decision. In actuality, Talcott was attempting to relegate Haley to the exit mechanism, in the hopes that Haley would opt to keep his capital in the LLC, because the mortgage liability would make it unprofitable for him to exit.

Section 18-802 permits the Chancery Court to order dissolution of an LLC whenever it is not reasonably practicable to carry on the business in conformity with the LLC agreement. The court stated that the exit mechanism was relevant to determining whether or not it was reasonably practicable for the LLC to carry on its business. Moreover, the court stated that Delaware’s commitment to freedom of contract should at least cause a reasonable exit mechanism to influence their decision. In this regard, Talcott argued that 1) it was practicable for the LLC to continue business because the LLC was operating successfully despite the deadlock, and 2) the presence of an enforceable exit mechanism diffused any arguments that Haley might have had about the practicability of continuing an arrangement in which he could not break a deadlock and be excluded from management.

The court refused to accept Talcott’s arguments. It reasoned that, although the exit
mechanism could have provided for the resolution of the deadlock (and allowed the business to continue in a reasonably practicable manner), the LLC agreement did not require the parties to resort to the exit mechanism as the exclusive means in resolving a deadlock problem.\footnote{Haley v. Talcott, 864 A.2d 86, 93 (Del. Ch. 2004).} Furthermore, even if it had, the exit mechanism did not expressly release Haley and Talcott from their personal guaranties given to secure the mortgage. The court therefore held that the exit mechanism was not a reasonably adequate or equitable alternative.\footnote{Id. at 88.}

In rejecting Talcott’s arguments, the court seemed to go out of its way to find reason to order dissolution. The court’s reasoning might be simply a reflection of sympathy for Haley. Then again, the court could have considered that other state LLC statutes expressly allow a court to order dissolution simply on the basis of finding deadlock or oppression.\footnote{See discussion supra Part II.B.}

\section*{B. The Court’s Borrowing of Other Governance Statutes}

Another way to view the court’s decision is in light of other corporate governance statutes. Because the LLC is a relatively new governance regime with little case law surrounding it, and because LLC statutes draw on partnership and corporation laws, the Chancery Court naturally looked elsewhere to reach its decision.\footnote{See Iowa Limited Liability Company Act, IOWA CODE ANN. § 490A.1302 (West 2004) (stating that judicial dissolution of an LLC may be granted “if it is not reasonably practicable to carry on the business in conformity with the articles of organization and any operating agreement”); see also Beverly-Killea Limited Liability Company Act, CAL. CORP. CODE § 17351(a)(1) (2006) (containing an analogous provision for judicial dissolution of an LLC as the above Iowa statute); Minnesota Limited Liability Company Act, MINN. STAT. ANN. § 322B.833 (2005) (permitting judicial dissolution of an LLC if “the governors or the persons having the authority otherwise vested in the board of governors are deadlocked in the management of the affairs of the LLC and the members are unable to break the deadlock”).} Part III.B.1 will analyze the Chancery Court’s use of DGCL section 273, and Part III.B.2 will analyze the DRULPA provision—section 17-802—that the court failed to use.

\subsection*{1. Delaware General Corporation Law Section 273}

The court found section 273 of the DGCL to be an appropriate framework for its analysis.\footnote{Haley v. Talcott, 864 A.2d 86, 93 (Del. Ch. 2004).} Although the Delaware Limited Liability Company Act placed an emphasis on the contractual nature of the LLC, the court reasoned that this case called for judicial dissolution. The court held that if the LLC were actually a corporation, judicial dissolution would undeniably be granted pursuant to section 273, reasoning that (1) the parties each owned fifty percent of the LLC, (2) the parties intended to be and were engaged in a joint venture, and (3) the parties were in deadlock over the LLC’s business strategy and future.\footnote{Id. at 94-95; see also Delaware General Corporation Law, DEL. CODE ANN. tit. 8, § 273 (2005).}

However, there are fundamental problems with the court’s analogy to DGCL section 273. First, the standards for dissolution under DGCL section 273 and Delaware Limited Liability Company Act (DLLCA) section 18-802 are completely different, which
undermines the court’s analogy to section 273. Unlike DGCL section 273, section 18-802 of the DLLCA is not limited to a company with two fifty percent stockholders. Moreover, under section 18-802, dissolution is proper upon frustration of the business purpose, which may include more than a disagreement on whether or not discontinuation of the business is desirable among the members (required by section 273). Third, LLCs are not corporations, and finally, the DGCL does not expressly provide commitment to freedom of contract like the DLLCA.95

2. Delaware Revised Uniform Limited Partnership Act Section 17-802

The court did not look to any provisions of partnership law in formulating its opinion, but it is worth noting that partnership law does not support the court’s ruling. DRULPA contains an analogous provision—section 17-802—to section 18-802 of the DLLCA.96 The provision allows a court to order dissolution if “it is not reasonably practicable to carry on the business in conformity with the partnership agreement.”97 Delaware courts are hesitant in ordering dissolution under section 17-802 and will not do so liberally.98 Because section 17-802 of the DRULPA is the direct counterpart of section 18-802 of the DLLCA, the Chancery Court should apply the same narrow discretion in cases involving claims under section 18-802.

The Chancery Court granted dissolution to Haley. It likely did not apply the same hesitation in ordering dissolution in Haley as it would have under a section 17-802 claim. For example, unlike the courts in Cincinnati Bell and Red Sail Easter, the Chancery Court found that Haley and Talcott could no longer carry out the purpose of the business, as contemplated in the operating agreement.99 The court expressly rejected Talcott’s insistence that the LLC was functioning in conformity with the agreement in receiving money from the Redfin Grill and meeting the mortgage payments.100 The court held that, although the LLC was “technically functioning,” the operation of the LLC was “purely a residual, inertial status quo that just happen[ed] to exclusively benefit one of the 50% members, Talcott."101

Yet the facts of Haley cannot be readily distinguished from the limited partnership cases in which the court denied petitions for dissolution under section 17-802. Essentially, all of the cases entailed disagreements between the partners over management operations where one party was in the position to control the business decisions. At the point of disagreement and inability to achieve his business desires, the party not in control sued for dissolution, claiming it impracticable to carry on the

95. See Delaware Limited Liability Company Act, DEL. CODE ANN. tit. 18, § 1101(b) (2005).
96. Delaware Revised Uniform Limited Partnership Act, tit. 6, § 17-802.
97. Id.
98. WALKER ET AL., supra note 1, at 49.
99. See Cincinnati Bell Cellular Sys. Co. v. Ameritech Mobile Phone Serv. of Cincinnati, Inc., No. 13389, 1996 Del. Ch. LEXIS 116 (Sept. 3, 1996) (holding there was no basis for judicial dissolution because the limited partnership could still reasonably carry on its business in conformity with the partnership agreement); Red Sail Easter Ltd. Partners v. Radio City Music Hall Prod., Inc., No. 12036, 1993 Del. Ch. LEXIS 154 (July 28, 1993) (holding that dissolution was not proper when the business could carry out the purpose of the partnership agreement).
101. Id.
partnership’s business purpose.

In Red Sail Easter, the court denied the petitioner’s request for judicial dissolution, reasoning that the limited partnership could achieve its purpose in conformity with the partnership agreement. The limited partners entered into the agreement with the general partner to finance the production of an Easter Show at Radio City Music Hall. The agreement had given the general partner “full, exclusive, and complete discretion in the management and control” of the limited partnership.

The partnership agreement deteriorated when the limited partners became dissatisfied with the management decision of the general partner and were unable to do anything about it. At that point, they petitioned for judicial dissolution. The court found that the general partner had pursued the business purpose (to finance a road show and exploit the Easter Show at Radio City Music Hall) of the limited partnership to its fullest and that the partnership’s business remained a viable economic prospect. The court reasoned that the limited partners’ dissatisfaction came from expectations that were not grounded in the legal duties of the general partner.

Similarly, in Cincinnati Bell, the Chancery Court refused to order dissolution, determining that the limited partnership could carry on its business in conformity with the partnership agreement. The limited partnership was formed to fund, establish, and provide cellular mobile services in certain geographic areas. The limited partnership relationship deteriorated when the general partner began offering long distance cellular services bundled with local cellular services, in competition with the limited partner’s landline services. The limited partner expressed concern about the bundling, but the general partner notified the limited partnership that he would continue the bundling service and the profits from it would accrue to the partnership. The limited partner petitioned for dissolution, claiming that the competition violated the partnership agreement, making it unable to practically carry on the business in conformity with the partnership agreement. The court found that the partnership agreement did not proscribe competition between the partners, and that the business was meeting its stated purpose of providing cellular services.

Subsequent to Haley, the Chancery Court faced a similar claim for judicial dissolution pursuant to section 18-802. In Silver Leaf, L.L.C., the court looked to section 17-802, rather than DGCL section 273. The court reasoned that since case law applying section 18-802 was sparse, it would find support for its decision by analogy to

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103. Id. at *6.
104. Id. at *19.
105. Id. at *32.
106. Id. at *7.
109. Id. at *2.
110. Id. at *13.
111. Id.
112. Id. at *20-21.
the limited partnership dissolution statute.\textsuperscript{115} Unlike Haley, in determining whether or not section 18-802 could be applied, the court started its analysis at the most natural place by analogously applying section 17-802.

The court analogized the facts in Silver Leaf to the limited partnership dissolution statute, section 17-802, because the language is essentially the same as the language in section 18-802.\textsuperscript{116} It then followed the type of analysis Delaware courts have given to section 17-802 claims. In doing so, the court first determined the intended business purpose of the LLC. The plaintiff, a capital corporation, agreed to form an LLC for the purpose of marketing a new vending machine that was supposed to dispense freshly cooked french fries.\textsuperscript{117} The machine’s manufacturing company signed a sales and marketing agreement with the LLC in consideration for a stock purchase agreement.\textsuperscript{118} Soon thereafter, the parties’ relationship deteriorated because of a dispute related to the stock purchase agreement, and the manufacturing company terminated the sales and marketing agreement.\textsuperscript{119} The capital corporation then petitioned for judicial dissolution, claiming the members were in deadlock because each party had a fifty percent ownership interest, and the operating agreement required majority vote for critical actions.\textsuperscript{120}

The court found dissolution appropriate due to the nature of the ownership structure and operating agreement.\textsuperscript{121} The court reasoned that the operating agreement, which mandated a majority vote to effectuate critical actions, provided no mechanism to break the impasse between the parties. Furthermore, the LLC had no business to operate anymore because the machine manufacturing company terminated the only asset of the LLC—the sales and marketing agreement.\textsuperscript{122} Therefore, the court held that the LLC was no longer able to carry on its business in a reasonably practicable manner.\textsuperscript{123}

In sum, many of the facts of Silver Leaf were analogous to those of Haley. Both cases entailed the formation and deterioration of an LLC, which resulted in a deadlock dispute. Additionally, both LLC operating agreements failed to provide an exit mechanism \textit{and} require the parties to resolve an impasse through such mechanism. Nevertheless, in Silver Leaf, the Chancery Court looked to section 17-802 rather than section 273 and similarly found it appropriate to grant dissolution.

Rather than condemning the section 273 line of reasoning in Haley, the court chose to distinguish Silver Leaf from Haley. The court held that section 273 of the DGCL was an inappropriate analysis, because there were three members of the LLC, as opposed to the two in Haley, and the business had been terminated, unlike the viable business at issue in Haley.\textsuperscript{124} Had Haley been decided under section 17-802, the outcome would have likely been different because the court would have been faced with a viable business, not the terminated business of Silver Leaf. Once again, the court in Haley

\textsuperscript{115} Id. at *39.
\textsuperscript{116} Id.
\textsuperscript{117} Id. at *1.
\textsuperscript{118} Id.
\textsuperscript{119} Silver Leaf, 2005 Del. Ch. LEXIS 119, at *2.
\textsuperscript{120} Id.
\textsuperscript{121} Id. at *45.
\textsuperscript{122} Id.
\textsuperscript{123} Id. at *44-45.
\textsuperscript{124} Silver Leaf, 2005 Del. Ch. LEXIS 119, at *39 n.82.
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seemed to have been determined to grant relief to Haley and to dissolve the LLC.

IV. RECOMMENDATION

Delaware courts will likely confront additional cases involving conflict between an LLC’s operating agreement and judicial dissolution of the LLC, especially since LLCs have grown in popularity. In deciding such conflicts, Delaware courts should strive to further the policies of the DLLCA (giving weight to the members’ freedom of contract) by generally deferring to the LLC’s operating agreement. Moreover, in analyzing judicial dissolution LLCs, Delaware courts should follow limited partnership principles. After all, section 18-802 of the Delaware Limited Liability Company Act is the direct counterpart of section 17-802 of DRULPA, containing essentially the same language. The judicial dissolution provision of the partnership act provides a better avenue for the courts’ analysis in judicial dissolution of an LLC than corporation law, because it encompasses judicial dissolution of entities with more than two members and allows dissolution upon frustration of the business purpose—which includes more than disagreement among the members about discontinuation of the business.

Conversely, the DGCL is limited to a two-member joint venture where the members share equal interests and allows judicial dissolution only if the members disagree upon whether or not to discontinue the business or how to dispose of its assets. Also, the DGCL does not have a provision expressly declaring its commitment to freedom of contract like the Delaware Limited Liability Company Act. Therefore, Delaware courts should develop a jurisprudence for LLC judicial dissolution similar to that of the limited partnership.

Because courts may find it inequitable to relegate the parties to a provision in the operating agreement, parties contemplating LLC formation and wishing to avoid judicial dissolution would be wise to do two things: (1) completely separate the departing member’s interest in the LLC in any exit provision, and (2) expressly provide for the resolution of a management deadlock.

Talcott had thought that he could relegate Haley to the exit mechanism, allowing him to buy out Haley’s interest and retain control over the business, while simultaneously forcing Haley to maintain a personal guarantee for the mortgage debt. As it turned out, Talcott thought wrong, and the Chancery Court ordered dissolution. If the parties had put in a provision calling for the purchasing member to release the selling member of all personal liability for borrowed money or other contractual obligations, and the operating agreement had ordered the parties to resort to the exit mechanism if deadlock arose, Talcott could have avoided judicial dissolution.
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The parties faced deadlock because Haley could not obtain a majority to change the existing company strategies, and neither of the parties wanted to leave—both were willing to buy the other out. Although the parties had a buy-out exit provision, the court did not see fit to force Haley to adhere to it, because the provision did not state that any member unhappy with an impasse must exit rather than petition for dissolution. In the future, LLC members should avoid deadlock by providing in their operating agreement that upon deadlock, one of the following three should occur: (1) dissolution, (2) arbitration, or (3) buy-sell arrangement.

In the future, LLC members should avoid deadlock by providing in their operating agreement that upon deadlock, one of the following three should occur: (1) dissolution, (2) arbitration, or (3) buy-sell arrangement.

In Haley and Talcott’s case, neither desired dissolution (a sale of the company and distribution of its assets). They both wanted to retain control over the company. Dissolution poses risks to the members of an LLC because “a third party could put in the highest bid and keep both members from the business.” Arbitration also may not have been an optimal solution for the parties. Because the parties were in a deadlock regarding a fundamental business policy, it would have been inappropriate for an arbitrator to decide such a matter and force the disagreeing member to continue his investment in the LLC.

The buy-sell arrangement in this case could have been enforced if the provision had expressly dealt with a deadlock and provided the selling member with full separation from the company’s liability. A buy-sell arrangement is probably the best solution for management deadlocks, because it allows the continuation of the company within the control of one of the original members. Furthermore, it does not force the members to continue the business in disagreement and provides the departing member with a fair value for his interest in the company.

V. CONCLUSION

Although relatively new, the LLC provides an appealing alternative for a corporate governance regime. LLC statutes give members considerable leeway in drafting their operating agreements. Courts seek to uphold the “freedom of contract” policy of the LLC statutes and will look first to the LLC agreement in deciding disputes among LLC members. Because LLC statutes draw upon other corporate governance statutes, and because there is little case law involving LLC disputes, courts will look to the relevant provisions in partnership and corporation laws.

Because the DRULPA contains an analogous judicial dissolution provision—section 17-802—to the Delaware Limited Liability Company Act, and because it encompasses more conflict situations than section 273 of the DGCL, the Chancery Court should seek to develop a jurisprudence for LLC judicial dissolution drawing upon the jurisprudence of the limited partnership. In doing so, the court will have limited and narrow discretion.

\begin{thebibliography}{9}

131. Goodgame, supra note 128, at 36.
132. Id.
133. Id.
134. Id. at 37.
135. Id. at 36.
\end{thebibliography}
to order judicial dissolution. Had the Chancery Court considered Haley under section 17-802, it probably would have found that it was reasonably practicable for the LLC to carry on its business and thus would have denied dissolution. The LLC was still an operating (and successful) business, and Haley could have resolved the deadlock by availing himself of the exit mechanism.

In cases where equity considerations override the “freedom of contract” policy, the court should be willing to order dissolution. The court found reason to do so in the case of Haley v. Talcott. This case teaches parties forming LLC agreements and wishing to avoid judicial dissolution that they should expressly provide a resolution for management deadlock and release the departing member of all the company’s liability and obligations in any buy-out exit provision.

137. WALKER ET AL., supra note 1, at 49.