Death by Auction: Can We Do Better?

*By Peter B. Ladig**

The purpose of a business divorce is to sever the business relationship between or among the owners of the business. The most common judicial means of achieving this goal is a state dissolution statute. Most state dissolution statutes empower courts to sever the business relationship through various means. Some states even permit the entity or the other equity interests to avoid dissolution by exercising a statutory right to buy out the plaintiff's interests. Delaware has eschewed this approach, instead providing few statutory directions or options and trusting its Court of Chancery to exercise its equitable discretion appropriately. Delaware courts historically were reluctant to dissolve operating, profitable entities, but in recent years Delaware courts have come to recognize the fallacy of forcing people to continue a business relationship that has fallen apart, and judicial dissolution is no longer the rarity it once was. A continuing problem, however, is that there is little common law guidance on how dissolution should be accomplished in a manner that is consistent with principles of Delaware law and that also recognizes the unique nature of these kinds of business divorces. In the absence of such guidance, Delaware courts default to what they know: an auction or sale process designed to attract the most number of bidders to maximize the entity's value. This article suggests that the Court of Chancery should not consider an auction or other public sale process to be the default solution, that general principles of equity permit the Court of Chancery to grant many of the statutory remedies available in other states, and that a forced public sale should be the remedy of last resort.

I. Introduction

The year is 1962, and two brothers, Aaron and Brad, decide to go into business together as equal partners in an S corporation delivering food products to the restaurant industry. Out of the back of their cars, they visit restaurant suppliers, developing relationships and building the business. Aaron and Brad each have one son about the same age, Andrew and Billy, respectively, and pass the business down to their sons. Andrew and Billy modernize and expand the business, obtaining ingredients from suppliers, selling some directly to restaurant suppliers, and transforming others into new products they also can sell to suppliers. Andrew and Billy also purchase land, build a plant, buy machinery, buy competitors, and grow the company to the point where it employs over 250 people in six locations.

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Andrew's two children, Alex and Allison, graduate from college but have no interest in continuing the family business. With no direct family legacy to pass on and no more college to pay for, Andrew decides he no longer wishes to be involved in the day-to-day operation of the business and would rather retire to Florida. Billy's children, Bob and Barbara, have an active role in the business. Billy wants to continue the family business so that Bob and Barbara will have a thriving business to step into when he retires.

This arrangement works well while Andrew and Billy are alive. Recognizing that the business continued to thrive after Andrew retired based in no small part on the contributions Andrew made while he worked at the company, Billy continues to distribute money to Andrew for him to pay taxes on his implied income and to share in the profits.

Tragically, Andrew and Billy die in a boating accident while Billy was visiting Andrew at his home in Naples, sending the shares of each into their respective estates. The executors of the estate, both non-family members, try to sell the company so that they can distribute cash to the family members. To prepare the company for sale, they agree to cause the company to enter into employment agreements with Bob and Barbara, who at that time were essentially running the company, with automatic raises and renewals and other perquisites contemplating a quick sale. They also agree to have the company establish a phantom stock appreciation plan to reward Bob and Barbara and certain non-family senior members of management for any increase in the value of the company when it is sold.

While the executors work well together, they have different views on the value of the company, and they cannot reach agreement on a sale. As a result, they have no choice but to distribute the shares of the company to Alex, Allison, Bob, and Barbara. The "grandchildren" now become the owners and directors of the company. Alex and Allison each worked at the company for a while, so they have some familiarity with the business, but not nearly the intimate knowledge that Bob and Barbara have. Alex and Allison, however, are highly educated and motivated—Alex has a master's degree in industrial engineering and Allison has a master's degree in business administration—and both are the chief breadwinners in their respective families. Bob and Barbara both graduated from college, but have spent their whole lives working at the company.

Although Alex and Allison have no desire to run the business, they sincerely believe that they can add value to the company through their own knowledge and experience. At board meetings they start to ask tough questions of management, including Bob and Barbara. Bob and Barbara, who never had to answer to anyone but their father, take offense at the questions being asked, and view Alex and Allison's queries as criticism of their management. Over time, Bob and Barbara become less responsive to the requests Alex and Allison make for information about the company's operations and finances, believing that Alex and Allison do not really have any value to add and merely want to second guess their management decisions. For their part, Alex and Allison become suspicious of Bob and Barbara because of their reluctance to provide them with information, so they continue to make requests for more and more detailed information.

The distrust spills over into the boardroom. Alex and Allison refuse to approve additional acquisitions or an expansion of the main plant, even though the current plant is at capacity and additional growth can be achieved only through expansion of the plant or acquisition of another company. Alex and Allison also hold up bonuses and other payments to management far after they ordinarily were paid in order to extract additional information about the business from Bob and Barbara. Alex and Allison want to renegotiate Bob and Barbara's employment agreements, but they cannot do so given the split at the board. Bob and Barbara fight back by withholding approval of tax distributions until the last minute in the hope of extracting concessions from Alex and Allison on the bonuses, plant expansion, and other business decisions.

Eventually, Alex and Allison consult a lawyer to help them with their situation. After consultation with the lawyer, they file an action seeking dissolution of the company through a public sale process. Bob and Barbara do not agree that the company should be sold. Bob and Barbara argue that the disruption of the sale process would be harmful to the company and its employees. They argue that because the company has been making and continues to make record profits every year, if any relief is necessary, it should be temporary, such as a custodian to break boardroom ties to eliminate the brinksmanship in which each side has engaged. If the company is to be sold, Bob and Barbara propose that the court order a "Russian Roulette" where one party makes an offer at which it is a buyer and a seller, and the other side has thirty days to decide whether to sell or buy at that price. Alex and Allison disagree with this proposal because of the informational disparity between the sets of cousins and their lack of operational expertise. The parties agree to let the court decide whether the company should be sold and, if so, how it should be sold.

Many parts of the scenario described above will be familiar to anyone experienced in business divorce. We will return to the hypothetical after setting out the relevant statutory background and judicial precedent to discuss how Delaware courts address the questions they have to decide in a business divorce. Because of Delaware's limited statutory authority in dissolution actions and lack of robust precedent in dealing with court-supervised sales, Delaware courts tend to view dissolution by public sale as the preferred, if not only, remedy available to them. The equitable authority of Delaware courts, however, should permit less intrusive remedies in the first instance, rather than jumping directly to a potentially terminal event in the life of the company and potential disruption of employees who may bear the burden of a sale without having caused any of the conditions that required it. Even if the court decides that a sale is necessary, a public sale process is not always the best. Delaware courts are familiar with a public sale process, so they put the burden on parties seeking to depart from this well-known process to justify the departure. This article suggests that due to the unique nature of business divorces, a public sale process should not be the default method of sale. The divergent motivations, and disparate positions of, the participants in many business divorces can make a public sale process suboptimal or, at a minimum, far more costly than it would in an ordinary sale process.

II. Delaware's Approach to Dissolution of a Business Entity

A. The Statutory Background

Although Delaware is one of the leading states in entity law, it offers relatively few options for dissolution compared to other states. The only statute that expressly addresses involuntary dissolution of a corporation at the request of a stockholder is section 273 of the General Corporation Law of the State of Delaware (the "DGCL").[1] Section 273 applies only to joint venture corporations with two stockholders, each owning 50 percent of the stock. If the two stockholders cannot agree whether to discontinue the joint venture, either one may petition the Court of Chancery for an order dissolving the corporation if the other stockholder does not agree to the petitioner's plan of dissolution.[2] Although the statute provides the court with discretion to decline to dissolve the corporation, Delaware courts have held that as long as the statutory prerequisites are satisfied, this discretion "should be sparingly exercised."[3] If the respondent cannot show fraud or bad faith in seeking a dissolution, courts generally will grant the petition.[4]

Although section 291 of the DGCL permits appointment of a "liquidating receiver" for an insolvent corporation,[5] no statute in the DGCL except for section 273 expressly references the Court of Chancery's ability to dissolve a *solvent* corporation, let alone dissolve a solvent corporation to resolve a dispute among its owners. Recently, however, stockholders seeking a business divorce have sought relief under section 226 of the DGCL. Section 226(a)(1) authorizes appointment of a custodian if the stockholders are deadlocked and cannot elect successor directors.[6] This subsection does not require a showing of any harm to the company to merit relief.[7] Section 226(a)(2) also authorizes appointment of a custodian upon a showing that:

> The business of the corporation is suffering or is threatened with irreparable injury because the directors are so divided respecting the management of the affairs of the corporation that the required vote for action by the board of directors cannot be obtained and the stockholders are unable to terminate this division.[8]

Regardless of whether a custodian is appointed under section 226(a)(1) or (a)(2), the statute provides that:

> [a] custodian appointed under this section shall have all of the powers and title of a receiver appointed under § 291 of this title, but the authority of the custodian is to

1. Del. Code Ann. tit. 8, § 273 (West 2016).
2. *Id.* § 273(a).
3. *In re* Data Processing Consultants, Ltd., C.A. No. 8907, 1987 WL 25360, at *4 (Del. Ch. Nov. 25, 1987).
4. *In re* Arthur Treacher's Fish & Chips, C.A. No. 5357, 1980 WL 268070, at *4 (Del. Ch. July 1, 1980).
5. Even here the plain language of the statute does not require liquidation of the corporation. Delaware courts, however, refer to a receiver appointed under section 291 as a "liquidating receiver." *See, e.g.*, Gibralt Capital Corp. v. Smith, C.A. No. 17422, 2001 WL 647837, at *8 (Del. Ch. May 8, 2001; rev. May 9, 2001).
6. Del. Code Ann. tit. 8, § 226(a)(1) (West 2016).
7. *Id.*
8. *Id.* § 226(a)(2).

continue the business of the corporation and not to liquidate its affairs and distribute its assets, except when the Court shall otherwise order.[9]

In most of the cases brought under section 226, the parties end up agreeing that the corporation should be sold to break the deadlock but disagree on how it should be sold.[10] In August 2015,[11] however, the Court of Chancery for the first time on its own and without the prior recommendation of a custodian entered an order under section 226 requiring sale of the company where one owner did not agree that the corporation should be sold or broken up in any fashion.[12] As discussed in more detail below, this decision is consistent with an emerging trend in the Court of Chancery to act more promptly than in the past to separate business owners.

Compared to the limited statutory authority to obtain dissolution of a corporation, Delaware's dissolution statutes for limited liability companies ("LLCs") and limited partnerships ("LPs") facially provide more room than the DGCL to order dissolution. The statutes, identical in all material respects, permit members or limited partners to seek dissolution of the entity if "it is [no] longer [reasonably] practicable to carry on the business of the [entity] in conformity with the [limited liability company agreement or partnership agreement]."[13] Although the statutes do not reference deadlock among the members, managers, or limited partners, the Court of Chancery has found often that such deadlock satisfies the statutory standard.[14]

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9. *Id.* § 226(b). A custodian appointed under section 226(a)(3), when the corporation has abandoned its business, is authorized under section 226(b) to liquidate the affairs and distribute the assets.

10. *See In re* Supreme Oil Co., C.A. No. 10618-VCL, 2015 WL 2455952, at *7 (Del. Ch. May 22, 2015) (order) (parties agreed on appointment of a custodian to sell company to break deadlock but disagreed on custodian's powers); EB Trust v. Info. Mgmt. Servs., Inc., C.A. No. 9443-VCL (Del. Ch. June 17, 2014) (order) (parties agreed that sale was necessary but disagreed on form of sale).

11. *See In re* Shawe & Elting, LLC, C.A. Nos. 9661-CB, 9686-CB, 9700-CB, 10449-CB, 2015 WL 4874733 (Del. Ch. Aug. 15, 2015) (granting petition to dissolve corporation under section 226 and appointing a custodian to oversee a judicially ordered sale). The author of this article represented a party in this matter. This article does not purport to address the merits of this decision.

12. In *Bentas v. Haseotes*, C.A. No. 17223-NC, 2003 WL 1711856 (Del. Ch. Mar. 31, 2003), the Court of Chancery followed the recommendation of the custodian appointed under section 226 and one stockholder group and ordered a sale of the company in an auction over the objection of the other stockholder group. Although the dissenting stockholder group initially objected to the appointment of a custodian, it proposed that, if appointed, the custodian should divide the company between the two factions. *See* Bentas v. Haseotes, 769 A.2d 70, 79–80 (Del. Ch. 2000). The court rejected this proposal and instead granted the custodian the authority to explore whatever course of action he deemed appropriate. *Id.* When the parties presented their proposed plans of sale, however, neither side presented live witnesses, and the court was unwilling to resolve the factual differences or merits of the experts' contentions about the merits or flaws in each plan. In the absence of a trial, the court found that the only way to resolve the issues was to order an auction, a "default" position addressed later. *Bentas*, 2003 WL 1711856, at *4.

13. Del. Code Ann. tit. 6, §§ 17-802 (LPs), 18-802 (LLCs) (West 2016).

14. *Shawe*, 2015 WL 4874733, at *40; Vila v. BVWebties LLC, C.A. No. 4308-VCS, 2010 WL 3866098, at *7 (Del. Ch. Oct. 1, 2010); Haley v. Talcott, 864 A.2d 86, 94–95 (Del. Ch. 2004) (applying policy of section 273 to find that deadlock met standard of section 18-802). The deadlock need not be among equally divided members, managers, or partners. In *In re Interstate Genoa Media Holdings, LLC*, C.A. No. 9221-VCP, 2014 WL 1697030 (Del. Ch. Apr. 25, 2014), the deadlock

Deadlock is not the only means of satisfying the statutory standard for dissolution of an LLC or LP. A change in circumstances making it impossible for the entity to operate in accordance with the agreement also satisfies the statutory standard. Historically, Delaware courts looked only to the four corners of the governing agreement, and specifically the purpose clause, to determine whether the entity can be operated for its purpose despite the change in circumstances and rejected arguments based on the parties' expectations not memorialized in the agreement.[15] Recently, however, the Court of Chancery held that "other evidence of purpose may be helpful as long as the Court is not asked to engage in speculation."[16] There, the Court of Chancery looked to other agreements executed contemporaneously with the LLC agreement to conclude that the purpose of the LLC had been frustrated by one member's termination of one of those agreements.[17]

None of the dissolution statutes in Delaware speak directly to the manner in which the dissolution may or even must be accomplished.[18] Nor do the dissolution statutes provide options short of a "dissolution" that the court may order. Presumably, if some remedy is warranted, the Court of Chancery will fashion the remedy using its equitable powers to ensure fairness.

B. The Change in Approach

Historically, Delaware, like many other states, treated judicial dissolution of a business entity as a remedy to be employed sparingly, and only under the most extreme circumstances. In *Hall v. John S. Isaacs & Sons Farms, Inc.*,[19] the Delaware Supreme Court held that:

> Under some circumstances courts of equity will appoint liquidating receivers for solvent corporations, but the power to do so is always exercised with great restraint and only upon a showing of gross mismanagement, positive misconduct by the corporate officers, breach of trust, or extreme circumstances showing imminent danger of great loss to the corporation which, otherwise, cannot be prevented. Mere dissension among corporate stockholders seldom, if ever, justifies the appointment of a receiver for a solvent corporation. The minority's remedy is withdrawal from the corporate enterprise by the sale of its stock.[20]

necessary to satisfy the statute was created because the LLC agreement required two members of the management committee to agree on all important actions.

15. *See* Roth v. Laurus U.S. Fund, L.P., C.A. No. 5566-VCN, 2011 WL 808953, at *3 (Del. Ch. Feb. 25, 2011); *In re* Seneca Invs., LLC, 970 A.2d 259, 263 (Del. Ch. 2008); Cincinnati Bell Cellular Sys. Co. v. Ameritech Mobile Phone Serv. of Cincinnati, Inc., C.A. No. 13389, 1996 WL 506906, at *5 (Del. Ch. Sept. 3, 1996), *aff'd*, 692 A.2d 411 (Del. 1997).

16. Meyer Natural Foods, LLC v. Duff, C.A. No. 9703-VCN, 2015 WL 3746283 (Del. Ch. June 4, 2015).

17. *Id.* at *5.

18. *See* Del. Code Ann. tit. 8, §§ 226, 273 (West 2016); Del. Code Ann. tit. 6, §§ 17-802, 18-802 (West 2016).

19. 163 A.2d 288 (1960). For a more detailed discussion of the historical treatment of dissolution by Delaware and other states, see Peter B. Ladig & Kyle Evans Gay, *Judicial Dissolution: Are the Courts of the State that Brought You In, the Only Courts that Can Take You Out?*, 70 Bus. Law. 1059, 1061–63 (2015).

20. *Hall*, 163 A.2d at 293 (citations omitted).

Although the court in *Hall* was addressing an equitable claim for dissolution, the reluctance to interfere with corporations is reflected in the DGCL, which provides an express statutory right to judicial dissolution only in "50–50" corporations. The absence of an express dissolution remedy in the DGCL for stockholders of non-"50–50" corporations implies a legislative hesitancy, which Delaware courts embraced, to permit an easy escape from the corporate form.[21]

More recent decisions evidence an erosion of the judicial aversion to dissolving a solvent entity. The erosion occurred in part because the Court of Chancery began to question the social and economic utility of requiring business partners to continue to work together in an already broken relationship or forcing them to keep working together until the relationship can no longer be salvaged. In *Huatuco v. Satellite Healthcare*[22] the Court of Chancery had to decide whether the members of an LLC waived the right to seek judicial dissolution under the LLC Act in their operating agreement. In acknowledging that the analysis would be different if the question were whether the members could divest the court of the authority to dissolve the entity under all circumstances, the court noted the philosophical issues raised by the notion that equity and the law would require two warring business partners to maintain an economic relationship:

> Whether the parties may, by contract, divest this Court of its authority to order a dissolution in *all* circumstances, even where it appears manifest that equity so requires—leaving, for instance, irreconcilable members locked away together forever like some alternative entity version of Sartre's Huis Clos—is an issue I need not resolve in this Memorandum Opinion. As I find below, considerations fundamental to equity are absent here.[23]

The Court of Chancery found the equities described in *Huatuco* present in *In re Carlisle Etcetera LLC*[24] to avoid, in part, the dilemma described in *Huatuco*—a locked-in, silent passive investor with no reasonable means to exit the venture. The facts in *Carlisle* tell a story familiar to anyone experienced in business divorce. The Royal Spirit Group and Tom James Company teamed up to capitalize quickly on a potential acquisition.[25] To facilitate a prompt acquisition, the parties entered into a simple LLC agreement in anticipation of negotiating a more detailed agreement later, received the same amount of equity interests, and split control of the managers, but an executive from Tom James Company was named chief executive officer of the venture.[26] After forming the venture, the Royal Spirit Group entity that was the member transferred its membership interest to a subsidiary for tax purposes.[27] Tom James Company—which ironically, also transferred its interest

21. *E.g.*, Giancarlo v. OG Corp., C.A. No. 10669, 1989 WL 72022, at *3 (Del. Ch. June 23, 1989) ("Delaware courts have traditionally demonstrated caution to the point of reluctance in appointing receivers for solvent corporations.").
22. C.A. No. 8465-VCG, 2013 WL 6460898 (Del. Ch. Dec. 9, 2013), *aff'd*, 93 A.3d 654 (Del. 2014).
23. *Id.* at *1 n.2.
24. 114 A.3d 592 (Del. Ch. 2015).
25. *Id.* at 595.
26. *Id.*
27. *Id.*

and whose executive was the CEO of the LLC—knew about the transfer and did not object.[28] The drafts of the more detailed agreement all considered the "transferee" the member of the LLC.[29]

The relationship soured before the members executed the more detailed LLC agreement. As a result, the member whose executive was the CEO essentially ran the company without oversight because the simple agreement required decisions by the managers to be unanimous.[30] The simple operating agreement provided no exit mechanism and the parties were unable to reach a negotiated resolution, so the Royal Spirit Group member sought judicial dissolution of the entity.[31] Tom James Company argued that because the simple LLC agreement did not alter the default rule in the LLC act that an assignee of a membership interest does not become a member unless otherwise provided in the LLC agreement,[32] the assignee was not a member and, therefore, did not have standing to seek judicial dissolution.[33]

The Court of Chancery agreed that the transferee lacked standing to seek a statutory dissolution, but did not stop its analysis there. The court addressed the question unanswered in *Huatuco*—whether the court can dissolve an entity on equitable grounds if statutory dissolution is not available. In reaching its conclusion, the court based its reasoning, in part, on the flexibility of equity to adapt to changing needs and on the notion that certain of the characteristics of an LLC, such as limited liability and perpetual existence, exist solely because of the LLC's relationship to the sovereign and cannot be created by private contract.[34] Based on these principles, the court held that the facts in *Carlisle* presented

> the type of situation anticipated in *Huatuco* where equity should intervene. If the opportunities for dissolution are limited to Section 18-802 and the specific terms of the Initial LLC Agreement, then dissolution is not an option. [The former member and its assignee] lack standing to seek it, and James does not want it. The Company will continue, with Royal Spirit locked-in as a silent and powerless passive investor.
>
> That situation is contrary to the bargain the parties struck. . . . The real relationship between the parties is a joint venture in which they are equal participants. Neither party intended to be a "passive investor . . . subject to [the other party's] unilateral dominion."[35]

Delaware courts have also indicated greater willingness than in the past to exercise their powers, statutory or equitable, at an earlier stage so that the law does

28. *Id.*

29. *Id.* at 596.

30. *Id.* at 596–97.

31. *Id.* at 597.

32. Del. Code Ann. tit. 6, § 18-702(b)(1) (West 2016) (establishing default rule that unless otherwise provided in the operating agreement, assignee cannot exercise the powers of a member).

33. *Carlisle*, 114 A.3d at 597.

34. *See also* Del. Code Ann. tit. 6, § 18-1104 (West 2016) ("In any case not provided for in this chapter, the rules of law and equity, including the rules of law and equity relating to fiduciary duties and the law merchant, shall govern.").

35. *Carlisle*, 114 A.3d at 606–07.

not require a complete breakdown in the relationship before the court will act. The Court of Chancery's comments during oral argument on a motion for summary judgment in *In the Matter of Bermor, Inc.*[36] exemplify this trend.

Bermor involved the second generation of two families, the Cohens and Grossmans, who had known each other for almost fifty years and had jointly owned and operated commercial real estate properties for almost as long.[37] In 1992 the patriarchs of the families established two Massachusetts limited partnerships to own the properties.[38] The limited partnership interests were distributed to various members of the families, but each family collectively held half of each limited partnership.[39] Each limited partnership agreement contained a provision prohibiting limited partners from seeking dissolution or taking acts that would result in the dissolution of the limited partnership.[40] A Delaware corporation, owned equally by one member of the Cohen family and one member of the Grossman family, served as the general partner of each limited partnership.[41] Members of the Cohen family owned the management company that managed the properties, thus giving the Cohen family day-to-day control.[42]

Around 2012, Louis Grossman, the "Grossman stockholder" of the two general partners, began to suggest that the limited partnerships engage in transactions that would provide more liquidity for the limited partners.[43] The Cohens were content with the existing financial arrangement and believed that the transactions proposed by Mr. Grossman were inconsistent with the intent of the patriarchs.[44] Although the Cohens were willing to consider alternative arrangements to satisfy Mr. Grossman's requests for liquidity, the families could not reach agreement.[45]

Mr. Grossman then filed an action in Delaware under section 273 of the DGCL seeking dissolution of the two general partners. The Cohens argued that the inability of the two families to agree on a transaction to provide liquidity to the limited partners did not satisfy section 273's requirement that the stockholders disagree on whether to continue the joint venture.[46] In addressing that argument on cross-motions for summary judgment, the court questioned the benefit of waiting until the relationship between the two stockholders deteriorated past the breaking point before the Court of Chancery offered relief:

> [I]t is true that in the precedents the relationships between the 50/50 holders seem to have deteriorated far further than they have in this case. But why is inviting that

36. Transcript of Oral Argument, Consol. C.A. No. 8401-VCL (Del. Ch. June 30, 2014) [hereinafter Bermor Transcript].

37. Certain of the facts underlying *Bermor* are drawn from the court's post-trial decision. *In re* Bermor, Inc., Consol. C.A. No. 8401-VCL, 2015 WL 554861, at *1 (Del. Ch. Feb. 9, 2015).

38. *Id.*

39. *Id.*

40. Bermor Transcript, *supra* note 36, at 21.

41. *Bermor*, 2015 WL 554861, at *1.

42. *Id.* at *2.

43. *Id.*

44. *Id.*

45. *Id.*

46. *Id.* at *4; Bermor Transcript, *supra* note 36, at 14.

> eventuality a good thing? Like, I get that maybe people can work things out, and it's always good to let people have a chance to work things out, but also, there might be some prudence to the path that Mr. Grossman has taken where he's essentially said, Look, instead of let's have a series of meetings over the course of the next year where I continue to make my liquidity proposal, you continue to say no, I make X proposal, you say no, we get angry about each other, we end up having this history of conflict like in the precedent cases, let's recognize that that's probably going to happen and not damage our personal relationship.[47]

Although the court denied the motions for summary judgment, after trial the court ordered the two corporations dissolved. In rejecting the Cohens' argument that the dispute had not lasted long enough to warrant dissolution, at least as compared to other precedents under section 273, the court noted that section 273 "does not mandate that parties struggle until they have destroyed their relationship entirely and jeopardized their business."[48]

In *In re Shawe & Elting, LLC*,[49] the Court of Chancery showed its willingness to use its statutory powers where, arguably, the company continued to thrive notwithstanding the breakdown in the parties' relationship. Philip Shawe and Elizabeth Elting started a translation business out of their apartment in 1992. The business grew every year in revenue and profitability; for 2014, the last full year before the trial, the company's revenues exceeded $470 million, and its net income was $79.8 million.[50] Mr. Shawe and Ms. Elting served as co-CEOs of the company. As a result of a reorganization of the business in 2007, Ms. Elting held 50 percent of the shares, Mr. Shawe held 49 percent of the shares, and his mother, Shirley Shawe, held 1 percent of the shares.[51]

As a result of disagreements between Mr. Shawe and Ms. Elting, the parties filed numerous actions against each other in New York and Delaware. In the Delaware actions, Ms. Elting sought, among other things, the appointment of a custodian under section 226(a)(1) and (a)(2) to dissolve the holding corporation, TransPerfect Global, Inc. ("TPG"), through a sale.[52] Through a related action seeking to compel an annual meeting for the election of directors, the parties essentially stipulated that the requirements of section 226(a)(1) were satisfied.[53]

47. Bermor Transcript, *supra* note 36, at 19–20; *see also id.* at 29 ("But here, where I have a pretty clean 50/50 structure such that if people want to go their separate ways, they're eventually going to be able to go their separate ways, either under [section] 273 or [section] 226, part of me wonders whether it just doesn't make sense to cut to the chase in that regard. That's what I'm torn on.").

48. *Bermor*, 2015 WL 554861, at *4.

49. C.A. Nos. 9661-CB, 9686-CB, 9700-CB, 10449-CB, 2015 WL 4874733 (Del. Ch. Aug. 13, 2015). Although the name of the case might lead the reader to believe that the case involved dissolution of an LLC, the court's opinion addressed issues in a consolidated set of actions dealing with the various entities the parties had formed as part of their overall enterprise. The main issue before the court was whether to appoint a receiver to sell the holding corporation for most of the business under section 226 of the DGCL.

50. *Id.* at *4.

51. The parties structured the ownership in this fashion to allow the company to claim the benefits of being a majority women-owned business. *Id.* at *2.

52. *Id.* at *1.

53. *Id.*

The court found that the requirements of section 226(a)(2) were satisfied.[54] The court also found that, even though the company was highly profitable, that fact was not dispositive.[55] The court held that section 226 contemplates appointment of a custodian for solvent corporations, and "even a profitable corporation may be suffering or may be *threatened* with 'irreparable injury' in the traditional sense of that legal principle when the directors are so fundamentally divided respecting the management of the corporation's affairs that they are unable to govern."[56]

In arriving at the remedy, the court saw only three available options: (1) take no action; (2) appoint a custodian to serve as a tie-breaker; or (3) appoint a custodian to sell the Company so that Shawe and Elting could be separated "and the enterprise can be protected from their dysfunctional relationship."[57] The court rejected taking no action, holding that the current state of the company was "one of complete and utter dysfunction that is causing the business to suffer and threatens it with irreparable harm" and it would be "unjust to leave Elting with no recourse except to sell her 50 percent interest" in TPG.[58] The court also rejected appointing a tie-breaker because, among other things, given that Shawe and Elting were both young, the court would have to exercise oversight over the internal affairs of TPG for many years.[59]

Having found the other two remedies insufficient, the court ordered a sale of TPG. The court was unpersuaded by the argument that forcing a sale would give Elting a windfall to which she was not entitled because she had failed to bargain for it when the parties reorganized their business in 2007, holding that the statutory remedy applied by default.[60] The court also declined to exclude Shawe from bidding for the company in the sale process or to impose a non-competition agreement on Shawe.[61]

The court instructed the custodian to propose a plan to sell the company "with a view toward maintaining the business as a going concern and maximizing the value for the stockholders."[62] The court specifically ordered the custodian to consider a sale just between Elting and Shawe, an open auction, or any other process the custodian found "practicable."[63]

The custodian ultimately recommended a "modified auction" process in which Elting and Shawe could partner with third-party financial backers and the custodian could solicit bids from purchasers not necessarily interested in partnering with Elting or Shawe.[64] Shawe proposed to have the parties bid against each

54. *Id.* at *26–30.
55. *Id.* at *28.
56. *Id.*
57. *Id.* at *31.
58. *Id.*
59. *Id.*
60. *Id.* at *32.
61. *Id.*
62. *Id.*
63. *Id.*
64. *In re* Transperfect Global, Inc., C.A. Nos. 9700-CB, 10449-CB, 2016 WL 3477217, at *2 (Del. Ch. June 20, 2016; rev. June 21, 2016).

other in the first round. If the winning bid did not fall within a certain range, then the winning bid would serve as a stalking horse bid and the bidding would be open to third parties with the stalking horse having matching rights. The court rejected this proposal, in part because the lack of consistent company projections[65] would have made it difficult to establish the range of values Shawe's proposal would require.[66]

On appeal, Shawe argued, among other things, that the Court of Chancery should have attempted less drastic remedies before imposing the extreme remedy of a forced sale. The Delaware Supreme Court rejected that argument.[67] The Delaware Supreme Court found that that the Court of Chancery had attempted less intrusive measures, such as appointing the custodian immediately after trial to attempt mediation, and the Supreme Court was aware of other attempts at mediation in the related litigation in New York.[68] The Supreme Court did not disturb the Court of Chancery's conclusion that appointment of a tie-breaking director would not be sufficient to remedy the parties' issues. In reaching this conclusion, the Supreme Court held that appointment of a tie-breaking director custodian not only would have been expensive and intrusive, but it would not have facilitated a sale of the company as a whole that would have protected the company's other constituencies, like its employees.[69]

Finally, in an opinion issued the same day as the Supreme Court's opinion in *Shawe v. Elting*, the Court of Chancery appointed a custodian with more limited powers. In *Kleinberg v. Aharon*,[70] the plaintiffs sought appointment of a custodian due to deadlock at the board level and the inability of the stockholders to elect new directors to break the deadlock. After concluding the plaintiffs met the statutory prerequisites, the Court of Chancery considered whether to appoint a custodian. As in *Shawe*, the Court of Chancery concluded that it had three options: "decline to appoint a custodian and leave the parties to their own devices"; "appoint a custodian to sell the company"; or appoint a custodian with more limited powers.[71] The Court of Chancery rejected the first two options for largely the same reason: the utter dysfunction at the company had caused the business to suffer, which made it impractical to sell in its current condition.[72] Appointing a custodian who had the power to act as a seventh board member, however, could put the company in a position to address its current issues, including the deadlock.[73] The Court of Chancery was mindful of the risk identified in *Shawe* that appointing a custodian could enmesh the court

65. In the custodian's diligence process, Shawe and Elting provided him with wildly different projections. *Id.* at *3.

66. *Id.*

67. Shawe v. Elting, 157 A.3d 152 (Del. 2017).

68. *Id.* at 166–67.

69. *Id.* at 167.

70. C.A. No. 12719-VCL, 2017 WL 568342 (Del. Ch. Feb. 13, 2017).

71. *Id.* at *14.

72. *Id.*

73. *Id.*

into the company's corporate governance for an extended period of time, but saw more potential for good in this case. The Court of Chancery reasoned that

> a board majority could take action to move the Company forward and potentially resolve the current deadlock at the stockholder level. One path would be for the custodian to assist the board in developing a new business plan and raising capital by issuing additional equity against it. The new investors could well be in a position to change the balance of power at the stockholder level, which in turn would enable the stockholders to resolve the deadlock at the board level.[74]

The custodian appointed would have all of the powers of a director and certain special powers, such as the ability to call and set the date and time for meetings of the board, as well as set the agenda and preside over board meetings.[75] The custodian would also be responsible for documenting the actions taken by the board, including documenting any disagreement over what took place at the meeting.[76]

III. The Problem with Delaware's Approach

So, is there a problem? The answer is not as simple as the question. When courts considered dissolution a drastic remedy to be ordered only sparingly, it made sense to implement the dissolution through the equally drastic mechanism of a forced sale. In other words, if the parties permitted their business relationship to deteriorate to the point where they met the high standard necessary to justify dissolution of their entity, it was appropriate to impose on them the costs, risks to the enterprise, and corresponding potential diminution in value associated with a public sale process. A forced public sale almost always is disruptive to a business. Management must devote time to preparing the company's books and records for the due diligence process, and prospective buyers likely will demand facilities tours and meetings with management, just to name a few of the disruptions caused by any sale process. A forced sale also imposes risk on the rank-and-file employees—who likely had little to no role in creating the conditions necessitating judicial intervention—of losing their jobs under a new owner's management.

Recognizing the interests of non-party employees in a business divorce does not alter Delaware's longstanding rejection of consideration of constituencies other than the stockholders in a sale process.[77] A break-up or sale should not be the default remedy, so consideration of other constituencies is not inappropriate. Further, because any sale would be by court order and not necessarily

74. *Id.* at *14–15.

75. *Id.*

76. *Id.*

77. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (holding that board "may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders" but concern for non-stockholder interests is inappropriate when the company is being sold to the highest bidder).

the owners' volition, it is appropriate for the court to consider the effects its orders may have on society in general.

The "problem" is that the increasing willingness to dissolve Delaware entities is inconsistent with a one-size-fits-all approach to remedying the conditions establishing the statutory prerequisites. The means of dissolving an entity should be flexible enough to account for the reasons why the court ordered it. A more flexible approach to implementing dissolution recognizes that a forced public sale may not be equitable, practical, or sufficient under all circumstances, particularly with the unique characteristics of companies ordinarily involved in a business divorce. These unique characteristics range from how the parties came to be business partners, the differing roles in management of the business, and divergent interests in continuing the business after a falling out. In addition, an emotional component almost always further complicates a public sale process.

A. The Non-Negotiated Relationship

While Delaware's entity schemes are well-known for permitting private ordering of business relationships[78] and its courts are equally renowned for holding people to the agreements they make as part of the private ordering,[79] oftentimes the parties to a business divorce did not have the opportunity to negotiate exit strategies in advance. This type of situation can lead to complicated negotiations where it is unclear that equity is being done.[80]

A prime example of this scenario is when later generations of a family inherit the ownership of the business. Sometimes the decisions made by their predecessors impose governance and employment relationships on the current owners that they cannot change.

The recent dissolution of Supreme Oil Company, Inc. is one example of this dilemma. In *In re Supreme Oil Co.*,[81] the founder of the company passed away, leaving the company to his two daughters. Only one daughter's children had

78. *E.g.*, Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1078 (Del. Ch. 2004) ("The DGCL is intentionally designed to provide directors and stockholders with flexible authority, permitting great discretion for private ordering and adaptation."); Elf Atochem N. Am., Inc. v. Jaffari, 727 A.2d 286, 290 (Del. 1999) ("The [LLC] Act can be characterized as a 'flexible statute' because it generally permits members to engage in private ordering with substantial freedom of contract to govern their relationship, provided they do not contravene any mandatory provisions of the [LLC] Act.").

79. *E.g.*, Fisk Ventures, LLC v. Segal, C.A. No. 3017-CC, 2009 WL 73957, at *7 (Del. Ch. Jan. 13, 2009) ("The Court is in no position to redraft the LLC Agreement for these sophisticated and well-represented parties."), *aff'd*, 984 A.2d 124 (Del. 1009); *see also* Huatuco v. Satellite Healthcare, C.A. No. 8465-VCG, 2013 WL 6460898, at *6 (Del. Ch. Dec. 9, 2013) ("Permitting judicial dissolution where the parties have agreed to forgo that remedy in the LLC Agreement would . . . change in a fundamental way the relationship for which these parties bargained."), *aff'd*, 93 A.3d 654 (Del. 2014); *cf.* KFC Nat'l Council & Advertising Co-op, Inc. v. KFC Corp., C.A. No. 5191-VCS, 2011 WL 350415, at *14 (Del. Ch. Jan. 31, 2011) (holding that where charter and bylaw provisions were negotiated by sophisticated counsel, traditional rules barring consideration of parol evidence and construing documents against corporation do not apply).

80. To be clear, no criticism of the parties in *Supreme Oil* is intended. The factual scenario is used only as a baseline for discussion of the potential for inequitable results.

81. C.A. No. 10618-VCL (Del. Ch.).

roles at the company.[82] While the shares were held by the founder's estate, the executor tried to sell the company.[83] In contemplation of the sale, the executor caused the company to enter into employment agreements with the two employee-grandchildren that contained, among other things, automatic renewal with a 10 percent raise each year and a one-year non-compete.[84] The sale process failed, however, and the daughters inherited the company, including the benefits and burdens of the employment agreements with the employee-grandchildren.[85] Because the daughters held an equal share of the company and each nominated half of the board, the daughter whose children were not involved in the business had no means to terminate or otherwise alter the employment agreements approved by the executor.[86] As a result, the employee-grandchildren had evergreen employment agreements that, because of the automatic 10 percent raises, soon did not necessarily reflect market terms for employment in the industry.

Disputes between the parties led the daughter whose children were not involved in the business to seek relief under section 226.[87] The parties eventually agreed to appointment of a custodian to sell the company.[88] During the sale process, third-party bidders asked that all stockholders, including the employee-grandchildren who held a small amount of non-voting stock, enter into restrictive covenants.[89] The employee-grandchildren refused, as was their right, to enter into extended non-compete agreements without adequate compensation, which caused potential buyers to lower their bids.[90]

Ordinarily, the Court of Chancery would take the position that the company is worth only what it is worth with its current set of agreements. In *In re Scovil Hanna Corp.*,[91] then-Vice Chancellor Strine articulated this position at a hearing in which he discussed the obstacles to resolution of the dissolution of the parties' relationship. In discussing the potential request for a judicially imposed non-compete, the court stated:

> Is the company less valuable because there's no non-competes? Yes. Companies are less valuable. Guess what, guys; you're the business guys, Mr. Hanna and Mr. Scovil. Your company is less valuable if it has people who have talent and knowledge about the business and are not subject to a non-compete.

82. Verified Petition for Appointment of a Custodian [Public Version] at para. 11, C.A. No. 10618-VCL (Del. Ch. Feb. 11, 2015).

83. *Id.* at para. 12.

84. *Id.*

85. *Id.* at para. 2.

86. *Id.* at para. 12.

87. *Id.* at paras. 62–69.

88. C.A. No. 10618-VCL (Del. Ch. May 22, 2015) (amended and restated order appointing custodian and for custodian to undertake a sale process).

89. Report and Recommendation of the Custodian for the Sale of Supreme Oil Company Incorporated [Public Version] at 5, C.A. No. 10618-VCL (Del. Ch. Sept. 12, 2016).

90. *Id.* at 29–30.

91. Transcript of Oral Argument, *In re* Scovil Hanna Corp., C.A. No. 664-N (Del. Ch. Apr. 20, 2006).

> Because you two are the principals, if you retained for yourselves the ability to go compete, whatever the flip side of that value was you retain in yourselves individually. So you're asking me to increase the value of the business.[92]

The notion that when two business parties voluntarily agree to retain for themselves the ability to compete against their collective enterprise, they do so with the knowledge that it reduces the value of the enterprise, has intuitive appeal. In *Supreme Oil*, however, neither daughter had the ability to negotiate her relationship as business partners would when starting a new venture.[93] The company was decades old. Because of the age of the company and the executor's actions, it had existing contractual relationships that neither side could change when inheriting the company. Thus, unlike in *Scovil Hanna*, neither daughter *voluntarily* chose the structure. It was imposed on them due to actions wholly outside their control.[94]

Returning to the hypothetical at the beginning of this article, assume that a strategic buyer offers to purchase the company for $140 million, but only if the cousins agree to enter into non-compete agreements with commercially reasonable restrictions, for which each the cousins will receive commercially reasonable compensation.[95] If the cousins do not all agree to non-compete agreements, then the strategic buyer will offer only $120 million. Bob and Barbara demand $10 million in compensation for their non-competes. The buyer says it will agree to the $10 million demand, but would reduce its purchase price to $130 million. Assume also that Bob and Barbara are buyers and their offer is $125 million.

There are two logical results in this situation. If Bob and Barbara are comfortable exiting the business, they can agree to non-competes in exchange for $10 million and a reduced purchase price. That scenario, however, arguably results in a $10 million transfer of value from the company to Bob and Barbara without sharing it with Alex and Allison.[96] Alternatively, Bob and Barbara can refuse to enter into non-competes, leaving the custodian running the process with two potential transactions: a third-party deal for $120 million and Bob and Barbara's offer for $125 million. Assuming Bob and Barbara want to continue in the busi-

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92. *Id.* at 36.

93. While the daughters did negotiate a resolution of the estate issues that resulted in the corporate structure of Supreme Oil, it is fair to say that there were other factors influencing the negotiations such that the daughters were not approaching the issue on a clean slate.

94. To be clear, this is not a criticism of any of the parties in *Supreme Oil*, but merely noting the circumstances in which there is a potential for an inequitable outcome based on circumstances outside the parties' control.

95. Arguably, Bob and Barbara's non-competes should be worth more, as they have more intimate knowledge of the industry and the relationships with employees and customers that would permit them to compete more readily. *E.g.*, *In re* Transperfect Global, Inc., C.A. Nos. 9700-CB, 10449-CB, 2016 WL 3477217, at *4 (Del. Ch. June 20, 2016; rev. June 21, 2016) (rejecting request for reciprocal judicially imposed non-competes because market may view one person as a greater competitive threat, and reciprocal non-competes would transfer value to the "less competitive" owner). Whether the payments for a non-compete are equivalent is irrelevant, however, if Bob and Barbara are also buyers and refuse to enter into any non-compete.

96. *Id.*

ness, they have little incentive to agree to a non-compete, regardless of the terms. Bob and Barbara can get a "deal" by paying only $125 million for a company potentially worth $140 million.[97]

These results are easier to stomach if the cousins had agreed to their relationship in advance. Bob and Barbara could hardly be faulted for exploiting the terms of a negotiated relationship to their own advantage. After all, Alex and Allison are sophisticated people and should be held to their agreements. But in the hypothetical, their business relationship with Bob and Barbara was imposed on them.

B. Different Roles in Management of the Business

The differing role of the parties in the management of the company also makes business divorce cases unique. Many of these cases involve an operating business partner paired with a financial partner, who both view their own contributions to the business as critical to the success of the business and, therefore, worthy of additional consideration in a sale. The operational owner may view a sale process as unfair, giving the financial backer a windfall for which he put in no hard work. The financial backer receives a portion of the personal goodwill developed by the operator. The financial backer, on the other hand, believes that the operator created that personal goodwill using the assets paid for by the financial backer, so he should be entitled to his percentage interest in that goodwill.

These issues create the same kind of problems as in the non-negotiated relationship, but to a somewhat lesser degree. It is more difficult for the parties to exert leverage or extract benefit from a sale process simply because of differing beliefs about their respective contributions to the business.

But these issues can cause an informational difference between the parties that can be used as an advantage in the sale process. Owners involved in the day-to-day management of the business who are also buyers have an advantage over all other buyers. In theory, owner-bidders should be able to make a less conditional offer with fewer required representations and warranties than anyone else because of their superior knowledge. To comfort third parties that the insiders do not have an improper advantage, the person in charge of the sale process must devote substantial resources, at substantial expense, to monitoring existing management to ensure a level playing field.

The Court of Chancery typically empowers custodians in charge of a sale process with sufficient power to level the playing field between inside and third-party bidders. The issue is whether defaulting to a public sale process that gives an inherent advantage to inside bidders is the appropriate method to sell a company in dissolution. The Court of Chancery has recognized that, under similar circumstances, a public sale process of a company with a substantial stockholder may not attract potential bidders if the bidders cannot see a path

97. A cynic might suggest that even if Bob and Barbara are content with exiting the business, they might buy the company for $125 million, then flip it immediately to the third-party buyer for $140 million, allowing them to keep the extra $15 million in consideration for themselves.

to success.[98] Auction theory recognizes that, under these circumstances, a single-sealed bid auction reduces the informational and economic advantage an insider bidder might have.[99] Still, the informational disadvantage is a significant deterrent to public bidders absent substantial investment in the sale process itself.

C. Divergence Between Ownership and Employment Interests

Finally, the divergent interests between the parties in continuing to work in the business can create misaligned motivations not accounted for easily in a public auction. In a traditional sale scenario, an owner-operator's ownership interest is aligned with his employment interest—he has made a conscious decision to divest himself of ownership and employment. In a court-supervised sale, even if the owner sought the "sale" of the entity by filing a petition seeking that relief or agreed to it after filing, he may have done so only to facilitate the business divorce, and not due to any real desire to exit the business he has chosen. In a court-supervised sale he has no control over his ownership interest. Therefore, he will focus more of his energy on what he can control—protecting his employment interest.

Again returning to the hypothetical, consider a financial buyer who offers $135 million, subject to Bob and Barbara entering into new employment agreements for less compensation but the opportunity to hold a piece of equity in the new entity. Although on economic terms the financial buyer's offer may be superior to Bob and Barbara's offer, Bob and Barbara may view working for a financial buyer they hardly know for less compensation as less advantageous than buying out Alex and Allison at a lower price and taking on the risk associated with borrowing the funds necessary to do so. Thus, Bob and Barbara can stall the financial buyer's bid in favor of their own by exercising their personal rights, leading to less compensation for the stockholders as a whole.[100]

These divergent interests can also lead the owner-bidder to exercise any piece of leverage he can to preserve his right to continue to work in the industry. The Court of Chancery has the power to enter orders authorizing the custodian to execute certain documents on behalf of the stockholders to avoid the leverage of the "ministerial" hold out, such as refusing to sign a stock certificate or other document necessary to consummate a transaction. But the court to date has not em-

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98. *In re* Appraisal of Dell, Inc., C.A. No. 9322-VCL, 2016 WL 3186538, at *39 (Del. Ch. May 31, 2016) (discussing limited efficacy of go-shops in management buyout transactions).

99. *See* Jeremy Bulow, Ming Huang & Paul Klemperer, *Toeholds and Takeovers*, 107 J. Pol. Econ. 427 (1999).

100. This dilemma can extend even to key non-owner employees. Assume that Bob and Barbara rely extensively on their chief operations officer Carla. Carla knows the business inside and out and interacts with the employees on a day-to-day basis, and much of the success of the company is due to Carla's contributions. The financial buyer also wants Carla to continue, but she is hesitant to work for anyone other than Bob and Barbara. Replacing Carla is possible, but not without significant cost in efficiency and potential loss of employees loyal just to her. To account for this additional risk and cost, the financial buyer likely would reduce the purchase price.

powered a custodian to execute documents that potentially could increase personal liabilities or obligations, such as a tax election[101] or agreement to indemnify beyond the consideration received in the transaction that a third party might demand in a typical sale scenario. Moreover, just as the Court of Chancery in *Scovil Hanna* reacted negatively to the suggestion of a judicially imposed non-compete, in *Shawe* and *Supreme Oil*, the court rejected express requests to allow the custodian to impose or expand non-compete agreements on the parties, holding that the court did not have power to take away the personal liberty right to engage in a business without some equitable basis to do so.[102]

Owner-employees can exercise substantial influence over a court-supervised sale process without creating such an "equitable basis" by exercising or expressing personal rights, particularly the right to compete. As most third-party bidders will either want extended non-compete terms (strategic buyer) or new employment agreements with non-competes baked into them (private equity buyer), owner-operators can exercise a disproportionate amount of influence over the sale process by being tough negotiators for their own interests. Because most owner-operators are likely buyers in any sale process, they also can influence the sale process in their favor in a way that cannot be remedied or counteracted easily by the person in charge of the process or the court.

101. For example, most businesses in a business divorce are pass-through entities for tax purposes. To avoid the potential for unnecessary consents from regulatory agencies and third parties with contract rights triggered by a merger, the preferred sale method is a sale of the shares held by the owners. A stock sale can be deemed an asset sale for tax purposes, enabling the third-party buyer to achieve a step up in the tax basis of assets of the company, if the buyers and sellers make an election under 26 U.S.C. § 338(h)(10) (2012). The election actually increases the tax liability of the sellers, but the stockholders still net higher consideration because the buyer can pay increased consideration due to its ability to depreciate the assets from the increased basis after the sale. As the election increases tax liability, however, the court cannot compel the stockholders to make the election. The transaction can be restructured as a merger to obtain the same tax benefit, but only at additional cost and risk if a merger triggers consent rights in third parties or regulatory agencies.

102. *In re* Transperfect Global, Inc., C.A. Nos. 9700-CB, 10449-CB, 2016 WL 3477217, at *4 (Del. Ch. June 20, 2016; rev. June 21, 2016) ("I agree with Shawe that it would not be appropriate to impose non-competition or non-solicitation restrictions on a selling stockholder as a condition of the sale of the Company absent evidence of wrongdoing."); Transcript of Oral Argument on Second Motion to Modify Sale Order to Grant Custodian Supplemental Authority at 66–67, *In re* Supreme Oil Co., C.A. No. 10618-VCL (Del. Ch. Apr. 4, 2016) ("I'm not going to grant the relief that has been requested because it refers generally to restrictive covenants, which I think would encompass something that I would not grant, which would be a non-compete against employment or founding your own business or things like that. That, I think, for better or for worse, is Michael Leffler's ability to do, and if he wants to give that up, he can do so voluntarily, but I don't think anybody can force him to do that. I think that's both a liberty and a property interest that is protected by one might say not only Delaware law but federal law and constitutional law and philosophical principles going back to John Locke. If there is evidence of indications that what he's actually doing is misusing corporate assets, that's a different story, but that would be relief that I think would have to be applied for and I would have to grant based on a specific factual situation."); *but see* Fulk v. Wash. Serv. Assocs., Inc., C.A. No. 17747-NC, 2002 WL 1402273 (Del. Ch. June 21, 2002) (imposing a six-month non-solicit on both owners as condition of sale process due to one owner's threats to compete immediately if he were not the winning bidder).

D. The Emotional Component

On top of these complicating factors, business divorces almost always invoke an emotional component that can lead to economically irrational decision making. The effect of emotionally driven decision making in a business divorce cannot be underestimated. There are three main sources of antagonism in business divorces that can cause emotions to drive decision making; often more than one of these sources is present.

First, many business divorces arise out of disputes between partners who have known each other for some time, either as family or friends. The shared history of a personal relationship that usually predates the business relationship provides a ready source of additional emotional fuel to an already unstable situation. Reasonable disagreements about business decisions suddenly can turn into broader fights with partners seeking to relitigate the emotional wounds caused by events years in the past.

Second, as noted above, business divorces sometimes arise out of disagreements between the "inside" person and the "outside" person. This type of disagreement occurs in many permutations, such as the financial backer of the enterprise and the "brains" or "idea guy" in the operation, or ownership groups with differing managerial roles. The reluctance of either side to admit the significance of the other's contributions oftentimes sparks an emotional reaction.

Third, an owner's lack of involvement in the operations of the enterprise many times leads to emotionally tinged reactions. These disputes can arise from the financial backer–operator scenario, but also can emanate from situations like the hypothetical, where the business was passed to the second generation of a family, but only one side participates in management; or one partner was older and retired from an active role in the business but kept his ownership interest.[103] Regardless, when one owner is "on the outside," the insider-owner often views the outsider's criticisms or questioning of the insider's management as uninformed, lacking context, or simply harassment for the sake of harassment, without any merit. The outsider, on the other hand, often views the insider as being deceptive or opaque and not sensitive to the obligations the insider has to all stockholders.

These reactions are often magnified in the context of dividends or distributions from the business. All of the owners may incur passive tax liability, but usually those liabilities cannot be met without dividends or distributions from the business. The insiders, however, have an advantage in that they can extract economic benefits from the business through salary or other means. The outsiders, however, may be stuck with a large tax bill and no means to pay it unless everyone agrees to make distributions.

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103. As discussed in the hypothetical at the beginning of this article, the retired owner dilemma does not always lead to dispute. The active owner who worked alongside the retired owner is more likely to appreciate the retired owner's contributions, at least for a time, than the active owner who did not share in the trials and tribulations with the retired owner.

Regardless of the *actual* merit of the outsider's criticism or quality of the insider's management, each sees the views of the other as a personal attack not based on a reasonable disagreement, leading to an emotional response and potentially irrational behavior.

When a party makes allegations of affirmative wrongdoing by her business partner, the fact that allegations have been made is often more important than their veracity. Allegations of wrongdoing trigger emotional responses from the parties and can distract everyone involved from the aim of the process, which is to come to a sensible and fair separation of the parties. A disgruntled party can hold the potential claim over the head of her former partner to extract a better result. The accused may feel compelled to prove her innocence rather than address the issues at hand.

E. The Effect on a Sale Process

These factors unique to business divorces do not mesh well with Delaware's traditional approach to the sale of a company. Delaware courts review challenges to sale processes under the well-known holding of *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[104] and its progeny, which require a board to obtain the best value reasonably available.[105] That rubric applies to challenges to a sale process where the court reviews the actions of a board *ex post*. In a business divorce, however, the court has the opportunity to establish the rules in advance. With this opportunity, Delaware courts follow the auction theory that an auction with more bidders leads to a better price and, thus, promotes the objective that *Revlon* requires.[106] In the absence of evidence to the contrary, a public auction provides Delaware courts with a familiar process that it can review to determine whether value was maximized. For instance, in *Bentas v. Haseotes*,[107] one party objected to the proposed plan of liquidation by arguing that division of the assets between the two factions would result in better value.[108] The Court of Chancery overruled this objection, holding:

> Absent a trial, there is only one way, in the Court's view, to resolve the issues posed by the two pending motions—to conduct an auction. The reason is that only an auction will provide reliable information about what range of values is currently achievable in this market, without forcing the parties to incur irreversible risk. After an auction, the parties and the Court will know for certain whether a viable market for the Company (or any of its lines of business) exists, and whether a sale of the entire Company will generate bids that reflect the Company's intrinsic value. If

104. 506 A.2d 173 (Del. 1986).

105. *E.g.*, Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34, 44 (Del. 1993).

106. *See* Transcript of Rulings of the Court on Auction of Information Management Services, Inc. by Custodian at 4–5, EB Trust v. Info. Mgmt. Servs., Inc., C.A. No. 9443-VCL (Del. Ch. June 16, 2014) ("As a matter of auction theory, it can be shown and is shown regularly that an auction with N plus 1 participants will generate greater value than an auction with N participants.").

107. C.A. No. 17223-NC, 2003 WL 1711856 (Del. Ch. Mar. 31, 2003).

108. *Id.* at *2.

> (as the defendants speculate) the auction fails to attract any bidders (or any bidders willing to offer a fair price), the Court is free to decline to approve any sale, and to order a division of the assets according to the defendants' plan, or some other plan.[109]

Thus, without evidence to the contrary, the court viewed an auction as the only way it could have comfort that value would be maximized in the dissolution process.

The factors discussed in this subpart, however, do not mesh with a public auction or auction theory. Auction theory in large part presumes rational decision making and an owner's willingness to exit the business. A public sale also cannot account easily for the emotional component of a business divorce where a certain level of cooperation beyond what is legally required is necessary to negotiate and consummate a transaction. Moreover, the result of the process may be suboptimal given the influence that owners can place on the process by exercising their personal rights.

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A very real reaction to the problems of conducting a public sale in a business divorce might be, "So what? A well-run auction can address these issues and still lead to a good result." For anyone who has represented custodians or parties in these situations, however, the answer is that these issues dramatically increase the costs and risks of the public sale process. Many millions of dollars can be spent on the delays caused by dealing with the divergent motivations of the owner-operators who are acting well within their rights. Even when those motivations can be managed, because of the emotional factors present in a business divorce, the end result may not necessarily be satisfactory economically or equitably. Given that certain of the factors discussed above can be identified at the beginning of the process, like how the parties came into their ownership and the extent to which the owners wish to continue in the process, is there a way to provide relief short of defaulting to a public sale process in every instance? The way other states treat these issues can provide the first step toward a new approach.

IV. Other States Offer More Statutory Options

States that have adopted a version of the Model Business Corporation Act or have not copied the Delaware legislative scheme for entity law recognize an expanded set of grounds for court intervention in a business divorce scenario. First, for corporations most states expand the grounds for dissolution beyond mere deadlock at the stockholder or board level. The additional grounds for dissolution typically include "shareholder oppression,"[110] "fraud or gross misman-

109. *Id.* at *4.

110. *E.g.*, 805 Ill. Comp. Stat. 5/12.55(a)(2) (2015) (for public companies, oppression must be directed to petitioning shareholder); *id.* 5/12.56(a)(3) (for non-public companies oppression can be directed at petitioning shareholder in his or her capacity as a shareholder, director, or officer); N.J.

agement" or other malfeasance,[111] or the assets of the corporation being wasted.[112] Some, but not all, of the states that adopt a "non-Delaware" approach to corporate dissolution carry these additional grounds for dissolution over to LLCs.[113] Most limited partnership statutes, however, limit the grounds for dissolution solely to the "Delaware-type" standard of it no longer being reasonably practicable to carry on the business.[114]

Given the expanded grounds to seek relief from the courts, these states also provide a number of different statutory remedies short of dissolution or dissolution by public sale. One common remedy is a "buy-back" or "buy-out" provision permitting the non-petitioning party to elect to purchase the shares of the petitioner at a negotiated price or, in the absence of agreement, a price set by statute.[115] Some statutes permit the court to order one party to buy out the interest of the other at "fair value."[116] Other statutes authorize appointment of a provisional direc-

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STAT. ANN. § 14A:12-7(1)(c) (West 2015) (applying only to corporations with fewer than twenty-five shareholders); N.Y. BUS. ORGS. LAW § 1104-a(a) (McKinney 2015); 15 PA. CONS. STAT. ANN. § 1981(a)(1) (West 2015). Delaware has rejected the concept of a special set of judicially created rules to protect minority stockholders. Nixon v. Blackwell, 626 A.2d 1366, 1379–81 (Del. 1993).

111. CAL. CORP. CODE § 1800(b)(4) (West 2015); FLA. STAT. ANN. § 607.1430(3)(b) (West 2015) (applying only to corporations with fewer than thirty-sive shareholders); 805 ILL. COMP. STAT. 5/12.55(a)(2) (2015) (for public companies, fraud or illegality must be directed to petitioning shareholder); *id.* 5/12.56(a)(3) (for non-public companies fraud can be directed at petitioning shareholder in his or her capacity as a shareholder, director, or officer); NEV. REV. STAT. § 78.650(1)(b)-(c) (2016); N.J. STAT. ANN. § 14A:12-7(1)(c) (applying only to corporations with fewer than twenty-five shareholders); N.Y. BUS. ORGS. LAW § 1104-a(a); 15 PA. CONS. STAT. ANN. § 1981(a)(1).

112. CAL. CORP. CODE § 1800(b)(4); FLA. STAT. ANN. § 607.1430(3)(a) (West 2015) (applying only to corporations with fewer than thirty-five shareholders); 805 ILL. COMP. STAT. 5/12.55(a)(3) (2015) (public companies); *id.* 5/12.56(a)(4) (non-public companies); NEV. REV. STAT. § 78.650(1)(e) (2016); N.J. STAT. ANN. § 14A:12-7(1)(c) (applying only to corporations with fewer than twenty-five shareholders); 15 PA. CONS. STAT. ANN. § 1981(a)(2) (West 2015).

113. CAL. CORP. CODE § 17707.03(b)(5) (West 2015) (persistent and pervasive fraud and mismanagement or abuse of authority are grounds to dissolve LLC); FLA. STAT. ANN. § 605.0702(1)(b)(3) (West 2015) (member or manager of LLC may seek dissolution on grounds that members or managers in control have acted, are acting, or are expected to act in manner that is illegal or fraudulent); 805 ILL. COMP. STAT. 180/35-1(5)(A)–(B) (2015) (member may seek dissolution on grounds that member or manager has acted in a manner that is illegal or fraudulent or oppressive to applicant); N.J. STAT. ANN. § 42:2C-48(5) (West 2015) (permitting member to seek dissolution on grounds of oppression).

114. Texas takes a unique approach to dissolution. The Texas Business Organizations Code, which applies to all entities formed under Texas law, recognizes both deadlock and oppression and fraudulent actions as grounds for a remedy, but requires stockholders, members, or limited partners to seek a receiver first to remedy these problems. TEX. BUS. ORGS. CODE ANN. § 11.404(b) (West 2015). Only if the receiver cannot remedy the problem can the shareholder, member, or limited partner then seek dissolution. *Id.* § 11.405(a)(3). The one exception to this scheme is that members of an LLC may seek dissolution without first seeking a receiver on the ground that it is no longer reasonably practicable to carry on the business in conformance with the LLC agreement. *Id.* § 11.314(2).

115. CAL. CORP. CODE § 2000 (West 2015); N.Y. BUS. ORGS. LAW § 1118 (McKinney 2015); N.J. STAT. ANN. § 14A:12-7 (West 2015). The California and New York statutes permit the non-petitioning party or corporation to elect to buy out the petitioner. The election is irrevocable and ends the action and the petitioner need not prove a ground for dissolution. CAL. CORP. CODE § 2000(a); Ferolito v. Vultaggio, 99 A.D.3d 19, 25 (N.Y. App. Div. 2012) (election under section 1118 is irrevocable); N.Y. BUS. ORGS. LAW § 1118(a); *In re* Pace Photographers, Ltd., 525 N.E.2d 713, 717 (N.Y. 1988) (section 1118 election "relieved petitioner of the need to prove the allegations underlying his petition").

116. N.J. STAT. ANN. § 14A:12-7(8). The New Jersey statute also permits the court to order the majority shareholder to sell his shares to the minority shareholder. Muellenberg v. Bikon Corp.,

tor.[117] In addition, some statutes expressly state that dissolution should be ordered only if no alternative remedy is available.[118] Some state courts have implemented the same principle as a matter of common law or interpretation of the relevant statute.[119] As these statutory schemes recognize, dissolution by public sale is not the only way to provide a remedy in a business divorce situation.

V. Delaware Need Not Amend Its Statutes to Address the Issue

Delaware does not need to change its statutory scheme to permit its courts to consider many of the alternatives offered by other state statutes. Equity jurisdiction permits the Court of Chancery to implement many of these alternative remedies. It is well-settled that the general equity jurisdiction of the Court of Chancery "is defined as all the general equity jurisdiction of the High Court of Chancery of Great Britain as it existed prior to the separation of the colonies," except where there is an adequate remedy at law.[120] In 1945 the Delaware Supreme Court held that this jurisdiction "refers to that complete system of equity as administered by the High Court of Chancery of Great Britain."[121] Article IV, Section 10, of the Delaware Constitution establishes these powers as a constitutional minimum, unless there is an adequate remedy at law.[122] The Court of Chancery, therefore, may continue to exercise this "complete system" of equity until the General Assembly of the State of Delaware provides otherwise, subject to the constitutionally established minimum.[123]

One of the chief principles of the equity jurisdiction inherited by the Court of Chancery is its ability to adapt to new situations and circumstances. The Delaware Supreme Court quoted from *Pomeroy's Equity Jurisprudence* to explain that:

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669 A.2d 1382, 1389 (N.J. 1996); *see also* Fla. Stat. Ann. § 607.1434(3) (West 2015); 805 Ill. Comp. Stat. § 5/12.56(b)(11) (2015).

117. Fla. Stat. Ann. § 607.1434(2) (West 2015); 805 Ill. Comp. Stat. 5/12.56(b)(7) (2015); N.J. Stat. Ann. § 14A:12-7(1) (West 2015).

118. *E.g.*, Tex. Bus. Orgs. Code Ann. § 11.405(a)(3) (West 2015) (stockholder may seek liquidation of the company only after appointment of receiver and the court does not find plan presented by receiver feasible to "remedy the condition requiring appointment of the receiver").

119. *E.g.*, Constantine v. Lawnicki, No. 070498BLS1, 2007 WL 2429721, at *2 (Mass. Super. Ct. Aug. 13, 2007) (deferring ruling on request for dissolution despite apparent deadlock between two 50 percent owners "in deference" to commentary to dissolution statute that provides "the general policy of Massachusetts corporation law that involuntary dissolution should be available as a mechanism for resolving internal corporate disputes only in the case of true deadlock"); *see also* Arklow, Inc. v. Weadock, Nos. WOCV201300306C, WOCV2013-00063C, 2013 WL 7018662 (Mass. Super. Ct. Nov. 27, 2013) (refusing to "find definitively that there is a hopeless deadlock as to the management of the corporation" although one brother had tried to fire the other and refused, initially to approve renewal of line of credit); Rowley Auto Parts, Inc. v. Bontos, C.A. No. 06-2150, 2009 WL 2356687 (Mass. Super. Ct. July 30, 2009) (holding the "court is not entitled to lightly conclude that there is a deadlock for purposes of a petition to dissolve").

120. DuPont v. DuPont, 85 A.2d 724, 727 (Del. 1951).

121. Glanding v. Indus. Trust Co., 45 A.2d 553, 558 (Del. 1945).

122. Del. Const. art. IV, § 10; *see also In re* Carlisle Etcetera, LLC, 114 A.3d 592, 602 (Del. Ch. 2015).

123. *Carlise*, 114 A.3d at 602.

> the Chancellor always has had, and always must have, a certain power and freedom of action, not possessed by the courts of law, of adapting the doctrines which he administers. He can extend those doctrines to new relations, and shape his remedies to new circumstances, if the relations and circumstances come within the principles of equity, where a court of law in analogous cases would be powerless to give any relief.[124]

Emphasizing the flexibility of equity jurisprudence, the Delaware Supreme Court quoted from Woolley's *Delaware Practice*:

> It may safely be affirmed that the whole body of equity principles, both of right and remedy, was brought hither by our ancestors, together with the common law, on their emigration from England, as a part of their heritage of liberty. Much of it, no doubt, lay dormant for a long period, no occasion or demand for a resort to portions of it for many purposes having arisen, but gradually as the increasing population of the new country begot new relations, there arose controversies and contests growing out of business, and the necessities for the redress of injuries which resulted from the breach of duties or the non-performance of obligations, that called for the use of the means to enforce observance through ancient remedies.[125]

Based on this principle, "judicially created equitable doctrines may be extended so long as the extension is consistent with the principles of equity."[126] Courts can modify judicially created rules provided they have not been codified by statute.[127]

Courts have long recognized the power of a court of equity to dissolve an entity formed under the laws of its state of jurisdiction.[128] The legislature has codified the Court of Chancery's power to dissolve an entity, but has never codified the *manner* in which the dissolution may be implemented. Section 226 provides that a custodian appointed pursuant to that section to remedy deadlock should continue the business and not liquidate, "except when the Court shall otherwise order."[129] Thus, the plain language of that statute expressly reserves for the court the decision of whether to dissolve or liquidate and, if so, the manner in which it should be done. None of the dissolution statutes governing other entities specify the manner in which a dissolution may be accomplished. In the absence of any legislative restrictions on the Court of Chancery's power, the Court of Chancery has the "complete system" of equity at its disposal to determine the manner in which the dissolution should take place.

124. Schoon v. Smith, 953 A.2d 196, 204–05 (Del. 2008) (quoting 1 POMEROY'S EQUITY JURISPRUDENCE § 60, at 77–78 (5th ed. 1941)); *see also id.* at 206 (explaining that equity "'has an expansive power, to meet new exigencies'" and that the "'chancellors could adapt their system to meet changing needs without resorting to the fiction that they were merely interpreting and applying former rules'" (quoting 1 JOSEPH STORY, COMMENTARIES ON EQUITY JURISPRUDENCE § 53 (W.H. Lyon, Jr. ed., 14th ed. 1918); MCCLINTOCK ON EQUITY § 4 (2d ed. 1948))).

125. *Id.* at 205 (internal citation omitted).

126. *Id.*

127. *Id.*

128. *E.g.*, *Carlisle*, 114 A.3d at 601.

129. DEL. CODE ANN. tit. 8, § 226(b) (West 2016).

That complete system, however, can and should acknowledge that a public sale is not always optimal. The Court of Chancery recognized this principle in *In re Interstate General Media Holdings, LLC* (“*IGM*”).[130] In *IGM* the parties agreed that the LLC, which owned, among other things, the *Philadelphia Inquirer* and *Philadelphia Daily News*, should be dissolved but disagreed on the manner of dissolution. One group proposed a public auction with single-sealed bids, relying on the Court of Chancery’s holding in *Bentas* to argue that only a public auction would ensure the value of the entity would be maximized.[131] The other side wanted an open outcry, “English style” private auction among the members of the LLC, arguing, among other things, that due to the company’s precarious financial state, it could not survive the extended diligence process necessary for a public sale to attract bidders to justify the risk of a public sale.[132]

After a trial, the court ordered that the company be sold at a private auction among the members of the LLC and the guild representing the newspapers’ employees.[133] In analyzing the parties’ competing proposals, the court focused on whether there was a reasonable probability that a serious bidder would emerge in a public auction.[134] Three factors caused the court to conclude that it was “more likely than not” that a public auction would not result in the emergence of an additional serious bidder.[135] First, no serious bidders had emerged in the months since the inevitable sale of the company became public knowledge.[136] The few potential bidders who had shown interest no longer wished to participate after reviewing the company’s financial information.[137] Second, the minimum bid price the parties had agreed would begin any auction exceeded the valuation multiples for which all but one of the major newspapers had sold in the six years since the financial crisis of 2008,[138] making it very “expensive” for any third-party bidder.[139] Third, the parties agreed the company would be sold on an “as-is, where-is” basis with no representations and warranties and a waiver of any claims against the selling members.[140] The court held that, on the record before it, it was unlikely that any third party would participate “on that decidedly seller-friendly basis.”[141]

The court found two additional factors supported a private sale. Based on the testimony at trial, the court concluded that a private sale could be conducted more quickly than a public sale.[142] The court found the speed of the process

130. C.A. No. 9221-VCP, 2014 WL 1697030 (Del. Ch. Apr. 25, 2014).
131. *Id.* at *1.
132. *Id.*
133. *Id.* at *1, *14–15.
134. *Id.* at *12.
135. *Id.*
136. *Id.*
137. *Id.*
138. Jeff Bezos’ purchase of the *Washington Post* was the lone exception to this statistic. The court found that one of the experts hired by the parties testified credibly that Mr. Bezos’ purchase was a “vanity” purchase not driven by the economics of the transaction. *Id.* at *12 n.42.
139. *Id.* at *12.
140. *Id.* at *13.
141. *Id.*
142. *Id.*

an important factor because of the testimony from the company's management that the company was having difficulty retaining and hiring employees while the ownership issue remained unresolved.[143] In addition, the court held that a public sale would have been far more costly due to the need to retain legal and financial advisors to interact with potential buyers.[144]

Finally, the court rejected the argument that only a single-sealed bid would maximize the value paid in the auction.[145] The proponents of the single-sealed bid structure relied heavily on auction theory in their argument.[146] Applying auction theory to the hypothetical in this article, assume that Alex and Allison valued the company at $70 million and Bob and Barbara valued it at $100 million. In an "ascending bid" auction, Bob and Barbara would win at $71 million. In a single sealed-bid auction, Bob and Barbara would bid closer to their valuation number to ensure that they won, thereby delivering additional consideration to Alex and Allison beyond what they would receive in an ascending bid auction. The court would have found the theory flawed in this instance because Alex and Allison had a "toehold" or substantial equity position.[147] Bidders with a toehold in an ascending bid auction have an incentive to bid past their own valuation because each incremental bid has the chance of increasing their return even if they lose.[148] While Alex and Allison would risk paying more than their valuation, they would benefit from continuing to bid because even if they lost, they would receive more consideration than if they stopped bidding at their target price.[149]

Nevertheless, the Court of Chancery tends to stick with what it knows, particularly when it has the rare opportunity to establish the parameters of a sale process *ex ante*, rather than review the process *ex post* as it does in most of its cases. In *EB Trust*, the Court of Chancery held that the party seeking to deviate from the premise that more bidders is better bore the burden of proof.[150] In *IGM* the

143. *Id.*

144. *Id.* at *14.

145. *Id.* at *14–15.

146. *Id.* at *15.

147. *Id.*

148. *Id.* ("Because of their 'toeholds,' General American and Intertrust simultaneously are buyers and sellers in this auction. Consequently, when one side reaches the highest price it was willing to pay for the asset, it still has an incentive to keep bidding because even if it ultimately loses the auction, because it is also a seller, it will benefit from driving the price as high as possible.").

149. Ultimately, the party that sought the private, ascending bid auction *lost*. *See* Press Release, William B. Chandler III, Prevailing Bid Announced in Interstate General Media Holdings, LLC Auction (May 27, 2014) (on file with author) The story of IGM's sale did not end there. Just days after the auction and before the sale closed, the leader of the winning group, Lewis Katz, died in a plane crash. *See* Charles Levinson, *Philadelphia Inquirer Co-Owner Lewis Katz Killed in Plane Crash*, Wall Street J. (June 1, 2014, 7:46 PM), http://www.wsj.com/articles/phildelphia-inquirer-co-owner-lewis-katz-killed-in-plane-crash-1401631440. Gerry Lenfest, Mr. Katz's bidding partner, purchased Mr. Katz's stake and then donated the company to The Institute for Journalism in New Media under the auspices of the Philadelphia Foundation. Sydney Ember, *Philadelphia Publications Are Donated to Nonprofit*, N.Y. Times, Jan. 13, 2016, at B2.

150. Transcript of Oral Argument at 5, EB Trust v. Info. Mgmt. Servs., Inc., C.A. No. 9443-VCL (Del. Ch. June 17, 2014) ("The burden of proof, therefore, in my view, should be on the party seeking to restrict the number of participants here to the two existing stockholders to show why this is a unique circumstance in which the general tenets of auction theory simply do not hold.").

Court of Chancery did not address which party bore the burden of proof but posited the issue before it as whether a public auction would lead to additional bidders. While this tenet of auction theory is meritorious, as discussed above, the unique qualities of a business divorce case do not mesh easily with the presumption that more bidders will lead to a better result.

Indeed, the notion that auctions in a business divorce do not lead to optimal results has support in academic studies. In *Shotguns and Deadlocks*,[151] Claudia M. Landeo and Kathryn Spier argue that shotgun mechanisms provide the best chance for an equitable outcome—that is, as close to equal division of the assets or value as possible—in a business divorce. Landeo and Spier assert that when there is some kind of asymmetry between the parties, such as different information or fewer assets as is often the case in a business divorce, the auction will not lead to an equitable outcome.[152] In such auctions, the party with less information or fewer assets will bid lower than the asset value, enabling the informed party to buy the assets for less than they are worth and to obtain a greater share of the value of the company.

Landeo and Spier argue that court-designed shotgun mechanisms, such as a Texas Shootout or Russian Roulette, tend to reduce or eliminate the advantage that one party may have in a business divorce auction.[153] In a Texas Shootout, the parties each submit single-sealed bids, and the party submitting the highest bid must buy out the other party at that price. In the Russian Roulette, one party submits a number at which it is a buyer and a seller. The party receiving the bid then decides whether to buy or sell at that price. In each of these methods, the party with superior information or assets tends to bid closer to a true equal division to ensure it is the winner. Moreover, a court-designed auction can be tailored to the situation to address any potential asymmetries between the parties to ensure an equitable outcome.

For all of these reasons, the court should take a flexible approach to crafting the remedy in a business divorce. The court should focus first on whether a sale will be necessary and, in doing so, determine whether any or all of the unique factors discussed above might affect a sale process. That inquiry can be completed at an early stage of the proceedings. The Delaware Supreme Court long ago recognized that "there is no single blueprint"[154] that must be followed when selling a company. Delaware courts also are comfortable deciding at the pleadings stage whether enhanced scrutiny applies *ex post* to the sale of a public company based on the characteristics of the company or the terms of the transaction.[155] Just as courts can decide at the pleadings stage that a sale does not in-

151. Claudia M. Landeo & Kathryn Spier, *Shotguns and Deadlocks*, 31 Yale J. on Reg. 143 (2014) [hereinafter *Shotguns and Deadlocks*].

152. *Id.* at 168.

153. *Id.*

154. Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989).

155. *E.g.*, *In re* Synthes, Inc. S'holder Litig., 50 A.3d 1022, 1033–34 (Del. Ch. 2012) (dismissing *Revlon* claim challenging third-party merger because controlling stockholder's interest in receiving highest price available were aligned with stockholders and he received same consideration as other stockholders); *In re* Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59, 71 (Del. 1995) (affirming

voke enhanced scrutiny, so too courts should be able to determine *ex ante* whether the particular characteristics of the company fit nicely within auction theory or whether a more particularized approach is warranted without imposing on one party the burden of proof. This is especially true when the court appoints an independent custodian to run the sale process. The custodian's interests are aligned with the owners in achieving the maximum value reasonably available, thereby eliminating at the outset some of the chief concerns animating Delaware courts' sale process jurisprudence.[156]

By addressing at the outset the unique, objective factors that might affect the sale process, the court can determine whether a trial is necessary and, if so, better focus the parties on the key issues for that trial. For example, in our hypothetical, the court could recognize at the outset that Bob and Barbara have employment agreements and phantom stock rights that would allow them to exercise substantial influence over a public sale process. The court then can focus the parties on how those factors might influence a sale process and determine whether a different type of sale process is appropriate under the circumstances or whether a lesser remedy would be more appropriate under the circumstances.

Alternatively, the court could determine that based on the employment agreements, Bob and Barbara's inherent knowledge of the company, and the lack of any non-competition or non-solicitation agreements between the Company and Bob and Barbara, a public sale process is unlikely to generate significant third-party interest to justify the cost. If, however, Bob and Barbara have standard restrictive covenants and the business is in stable financial condition such that it would be attractive to third parties, then the cost and potential increase in value of a public sale may generate the best outcome.

These factors could be ascertained or at least identified as key factors relatively early in any proceeding seeking dissolution through targeted discovery or court-ordered disclosures by the parties. The Court of Chancery also could appoint a custodian charged with investigating these factors and then presenting a recommendation based on the custodian's analysis of them. In analyzing these factors, the presumption should not be that a public sale is the preferred method and impose a burden on the party seeking dissolution to rebut that presumption. Instead, the factors should be analyzed objectively in a manner that takes into account the uniqueness of the situation.

The Court of Chancery's approach in *Kleinberg* is consistent with the flexibility suggested here.[157] There, the Court of Chancery recognized that the dysfunction at the company effectively precluded a sale process because it would have resulted in the equivalent of a fire sale of what had been, and likely continued

dismissal of *Revlon* claim because plaintiff failed to plead that control of corporation would not remain in a "'large, fluid, changeable and changing market'" (quoting Paramount Commc'ns Inc. v. QVC Network, Inc., 637 A.2d 34, 47 (Del. 1993))).

156. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (holding that in a change of control transaction, courts must be mindful of "the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders").

157. Kleinberg v. Aharon, C.A. No. 12719-VCL, 2017 WL 568342 (Del. Ch. Feb. 13, 2017).

to be, valuable assets.[158] By appointing a custodian with the full power of a director, the company's board would not be deadlocked, and the directors could actually take action to move the company forward.[159]

Sometimes all disenchanted directors or stockholder need in order to overcome what they may feel are ossified positions is to feel like they are being heard. For example, months or years of management directors rejecting or dismissing the complaints of non-management directors or stockholders often increases the frustration and suspicions of the "outsiders." Simply having a court-appointed independent decision maker present at board meetings or available to the outsiders can make the outsiders feel like their voices are being heard. If the custodian also has the power to take action against the insiders based on these complaints, the outsiders may no longer feel as if they have no control over the direction of the company. Further, empowering the custodian to order dividends or distributions or simply requiring that the entity make dividends or distributions to cover tax liabilities can take some of the economic pressure off of the parties and open the door for a more reasonable result.

The Court of Chancery, in employing the "complete system" of equity, should feel free to consider remedies short of dissolution employed by other states when not required by statute, as in section 226 and dissolution of LLCs. Remedies such as appointment of a custodian solely to break ties, ordering mediation, or cancellation of a provision in the bylaws or certificate of incorporation may be appropriate under the circumstances.

VI. The Limits on the Court's Powers

Although this article advocates for the Court of Chancery employing greater creativity in formulating remedies for the conditions satisfying the statutory prerequisites to justify court intervention, there is a limit to the court's powers in the "complete system" of equity absent statutory augmentation. The Court of Chancery can take action affecting the entity at issue and the ownership interests therein, but it cannot take action affecting personal property or property rights absent a specific equitable basis to do so.

In *Carlisle*, the Court of Chancery held that despite Delaware's contractarian leanings, an entity formed under its laws "is not an exclusively private contract" because the entity "has powers that only the State of Delaware can confer," including the separate legal existence of the entity and, usually, the shield of limited liability.[160] For that reason, and because, by statute, a dissolution is not a purely private affair, the Court of Chancery held that the state retains an interest in entities formed under its laws, in particular "having the Court of Chancery available, when equity demands, to hear a petition to dissolve an LLC."[161]

158. *Id.* at *14.
159. *Id.*
160. *In re* Carlisle Etcetera, LLC, 114 A.3d 592, 606 (Del. Ch. 2015).
161. *Id.*

The natural extension of this principle is that the state also retains an interest in the stock or other ownership interest in a Delaware entity with limited liability. Two private citizens cannot agree to limit their liability to third parties by agreement between themselves, and any transferee of the ownership interest or subsequent investor must assume the liability for all of the debts of the entity. Only the state can permit the new investors or transferees of the stock to acquire their interests without assuming all of the debts of the entity.

The court's authority to compel the sale of a party's ownership interest through a dissolution is unquestioned.[162] That authority should exist regardless of the manner in which that sale is conducted. Therefore, the Court of Chancery has the power in a business divorce proceeding to craft a remedy that affects the entity and the ownership interests in that entity. These remedies include, in addition to dissolution, appointing of a tie-breaking custodian or provisional director, or ordering a mediation. The court can also order one party to purchase the shares of another at a set price, through a Texas Shootout, Russian Roulette, or any other process crafted to meet the circumstances.

Arguably, the Court of Chancery also has the power to modify provisions of the entity's organic documents under appropriate circumstances. Although Delaware courts rightfully are loathe to rewrite parties' agreements, a case can be made that in those situations where the parties did not have the opportunity to negotiate their relationship in advance, such as when they inherit their ownership interests from a prior generation, the court would not be rewriting the parties' agreement, but rather using the irresistible force of the complete system of equity against the immovable object of contract rights to "'uphold, and enforce rights and duties which spring from the *real* relations of the parties.'"[163] Clearly, implementing this type of remedy must be done carefully, and only rarely, to address situations where the organic documents of the entity fail to reflect the "real" relations of the parties and the parties did not have the opportunity in advance to address the failure. Overuse of this type of remedy risks diluting the well-settled, and economically efficient, preference Delaware courts have to enforce agreements between sophisticated parties as written.

What the courts cannot and should not do absent statutory authority is take action affecting parties' personal rights unrelated to their ownership interests in the entity. As discussed earlier, Delaware courts have refused to impose restrictive covenants on owners absent evidence of malfeasance or interference in the sale process.[164] Nor should a court, absent statutory authority, compel an owner to execute a document that would increase her personal liability, at least beyond what she will incur in the transaction. Also, a court should not take any action

162. Shawe v. Elting, 157 A.3d 152, 165–66 (Del. 2017).

163. *Carlisle*, 114 A.3d at 607 (quotation omitted).

164. *In re* Transperfect Global, Inc., C.A. Nos. 9700-CB, 10449-CB, 2016 WL 3477217, at *4 (Del. Ch. June 20, 2016; rev. June 21, 2016); Transcript of Oral Argument on Second Motion to Modify Sale Order to Grant Custodian Supplemental Authority at 66–67, *In re* Supreme Oil, C.A. No. 10618-VCL (Del. Ch. Apr. 4, 2016); *In re* Scovil Hanna Corp., C.A. No. 664-N, slip op. at 36 (Del. Ch. Apr. 20, 2006) (court's ruling on respondent's motion for sanctions).

affecting the other contractual relationships between the company and the owner, such as employment agreements, phantom stock rights, or other agreements pursuant to which the owner has rights outside of his ownership interest.

Even with these limitations, recognizing that the Court of Chancery has more options to resolve the conditions requiring court intervention under the dissolution statutes or Section 226 aligns the remedies available with the increased willingness of the Court to intervene. This approach also acknowledges that the unique aspects of a business divorce do not necessarily lend themselves to easy resolution through commonly accepted sale processes. Rather, the court should pay particular attention to the characteristics of the company, owners and employees before determining the appropriate remedy. Much of this analysis can be performed without requiring the parties to engage in expensive, time-consuming and emotionally charged discovery or trial. Performing the analysis at an early stage may avoid trial or, at a minimum, permit a more focused trial on the key issues the court may have to resolve when deciding on the appropriate remedy.

Successful determination of the unique characteristics of the situation should result in a more efficient remedy. If a sale process is required, more refined process that does not consume excess time or resources, financial and otherwise, of the parties increases the return for everyone. Focusing more quickly on a remedy also gives the court more room to attempt remedies short of dissolution which may require some amount of time to implement, such as appointment of a provision director or custodian to break ties. The court can then put a time frame on the remedies secure in the knowledge that it can order dissolution later if the interim step does not solve the parties' problems.

VII. Conclusion

The law addressing the remedies available in a business divorce has not developed as quickly as the court's ability to recognize when relief is necessary. The Court of Chancery already has ample authority under the "complete system" of equity to craft bespoke remedies to address the conditions requiring court intervention and account for the singular aspects of a business divorce that make it less amenable to traditional sale process techniques. Addressing these issues promptly, and without devotion of substantial resources by the court or the parties, is consistent with Delaware decisional law and more efficient. More focused efforts on the problems that need to be addressed in the parties' relationship or the sale process itself should lead to less disruption and greater returns for the owners.