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## Dissolution and Rational Choice: The Unique Remedial Framework for Director Deadlock Under the Illinois Business Corporation Act

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# Dissolution and Rational Choice: The Unique Remedial Framework for Director Deadlock Under the Illinois Business Corporation Act

BY KENNETH J. VANKO<sup>1</sup>

*This article discusses the remedy of judicial dissolution in the context of an Illinois corporation facing management deadlock. The particular focus of this article is on one of the most common corporate structures for small businesses: the equally-held firm where management rights are symmetrical with ownership interests. Although courts long have described dissolution as an extreme and disfavored remedy, they have done so without reference to the particular factual context unique to deadlocked closely-held corporations. Illinois has a unique shareholder-relief statute, which illustrates when dissolution is an appropriate remedy. Based on the statutory text, I suggest dissolution is a default remedy in deadlock cases when a petitioning shareholder does not request a buy-out of her shares in the litigation and when the corporation's shareholders have failed to include deadlock avoidance mechanisms in their advance planning documents. As support, I demonstrate the motivations for why a shareholder in an equally-split firm may eschew a buy-out remedy altogether and prefer dissolution.*

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1. Member of Clingen Callow & McLean, LLC. I am dedicating this Article to Paul and Cindy Ruedi, clients who've inspired me, and William Lynch Schaller, the greatest mentor any young lawyer ever could have.

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## I. INTRODUCTION

Dissension among small-business owners often is rooted in powerful, emotional forces: family rivalry, a failure to communicate, and fractious disloyalty to name just a few.<sup>2</sup> The possibilities for discord increase when founders elect to split their ownership and management rights equally, leading to the potential for internal deadlock. To be sure, in a closely-held corporation,<sup>3</sup> “deadlock can be especially disabling.”<sup>4</sup>

The Illinois General Assembly has recognized the problems associated with shareholder dissension in closely-held, or non-public, corporations. Sec-

2. See *Smith-Shrader Co. v. Smith*, 483 N.E.2d 283, 291 (Ill. App. Ct. 1985) (refusing to order dissolution when one owner engaged in improper competition against corporation); *Kirksey v. Grohmann*, 754 N.W.2d 825, 830-31 (S.D. 2008) (ordering dissolution of equally-split limited liability company when four sisters, two of whom benefited from management deadlock, spoke only through their lawyers).

3. The case of *Galler v. Galler*, 203 N.E.2d 577, 583 (Ill. 1964), defines a closely-held corporation as “one in which the stock is held in a few hands, or in a few families, and wherein it is not at all, or only rarely, dealt in by buying or selling.” *Galler* further notes “the shareholders of a close corporation are often also the directors and officers thereof.” *Id.* at 584.

4. Diane K. McDonald, Comment, *Deadlock and Dissolution in the Close Corporation: Has the Sacred Cow Been Butchered?*, 58 NEB. L. REV. 791, 795 (1979).

tion 12.56 of the Illinois Business Corporation Act (BCA) is a robust substantive and remedial statute that authorizes a court to order equitable relief in different classes of shareholder disputes.<sup>5</sup> One statutory basis for shareholder relief is deadlock between or among directors, those who control the day-to-day managerial affairs of a corporation.<sup>6</sup> Though the entitlement to relief for deadlock seems unquestioned, the proper remedy is far from clear-cut.

In this Article, I examine the remedial structure of section 12.56 and its application to deadlock claims when there is symmetry between ownership and management, one of the most common organizational paradigms in closely-held companies. In doing so, I conclude that a shareholder petitioning for relief based on deadlock faces a binary choice arising from the statutory text: an election to sell her shares in the enterprise or a request that the court dissolve the firm. I also demonstrate that this stark choice directly correlates to the shareholder's forward-looking conduct and her desire to remain active in the corporation's line of business. Standing in the way of this choice, however, is the rule that dissolution is a drastic remedy courts should not invoke lightly. I illustrate why this prevailing view of dissolution does not – or should not – apply to the unique deadlock paradigm. To that end, I argue that courts ought to view dissolution as presumptively appropriate for deadlock cases given the high burden of proof a petitioning shareholder must meet before her entitlement to *any* relief.

In Part II, I examine the meaning of deadlock through illustrative case law from Illinois and other jurisdictions. I also analyze the crucial requirement that deadlock must disadvantage the shareholders or lead to going-concern injury.<sup>7</sup> Part III demonstrates the textual limitations of section 12.56 as it pertains to remedial choice in deadlock cases. I then discuss the share-purchase remedy in particular. In doing so, I conclude that the General Assembly's choice to place this remedy solely within the petitioning shareholder's control suggests dissolution is the rational alternative remedy in a deadlock case when a shareholder desires to remain in the firm's line of business.<sup>8</sup>

In Part IV of this Article, I deconstruct the dissolution remedy and show why courts have viewed it as a drastic remedy for corporations. After reviewing the common-law rules that gave rise to this perception, I posit that a profound disconnect emerges between black-letter historical rules and the unique factual construct of director deadlock.<sup>9</sup> Part V examines advance planning among shareholder-directors through private contract law. I discuss

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5. 805 ILL. COMP. STAT. 5/12.56 (2017).

6. 805 ILL. COMP. STAT. 5/12.56(a)(1) (2017).

7. See *infra* text accompanying notes 12-102.

8. See *infra* text accompanying notes 103-52.

9. See *infra* text accompanying notes 153-70.

sound deadlock avoidance mechanisms that are available to owners of the equally-divided firm and discuss the inherent limits, both behavioral and practical, of advance planning.<sup>10</sup>

Part VI returns to dissolution and reconstructs it from a disfavored remedy under section 12.56 to a default solution in deadlock cases. In this section, I analyze the circumstances in which a petitioning shareholder is motivated to seek dissolution. In doing so, I conclude that dissolution is a preferred remedy if the petitioning shareholder elects not to sell her shares in the firm and if the shareholders have failed to plan for deadlock in their internal corporate contracts. In this respect, dissolution follows a shareholder's rational decision to remain in the same industry as the deadlocked firm, free of common-law restrictions on competitive conduct.<sup>11</sup> Part VII then concludes the Article.

## II. DEFINING CORPORATE DEADLOCK

Deadlock in the closely-held corporation is a function of advance planning among owners. In the simplest case, the corporation's voting stock is split equally between two owners (or sometimes two families), who are also the lone directors.<sup>12</sup> Taking it further, the bylaws may require that the owners elect each other as directors.<sup>13</sup> Owners of an equally-split corporation often lack the foresight to establish an independent board of directors, or one that is not symmetrically aligned with ownership.<sup>14</sup> And even in cases where the shareholder factions are not equally split, the corporate bylaws may facilitate deadlock through super-majority voting requirements.<sup>15</sup>

Although close-corporation owners can avoid deadlock, poor advance planning does not mean that shareholders lack remedies when serious disputes arise. The BCA enables a court to intervene and order relief that will cure deadlock. Section 12.56(a)(1) provides that director deadlock is a basis

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10. See *infra* text accompanying notes 171-221.

11. See *infra* text accompanying notes 222-87.

12. *Galler*, 203 N.E.2d at 583-84; *Bowen v. Bowen-Romer Flour Mills Corp.*, 217 P. 301, 302 (Kan. 1923). For a case about a corporation with classic deadlock-enabling features, see *Bendetson v. Killarney, Inc.*, 913 A.2d 756 (N.H. 2006) (affirming order of judicial dissolution).

13. Carlos S. Israels, *The Sacred Cow of Corporate Existence: Problems of Deadlock and Dissolution*, 19 U. CHI. L. REV. 778, 779 (1952).

14. See Carl Kampel, *Why Privately Held and Family-Owned Businesses Should Have Independent Boards of Directors*, FEI (Feb. 12, 2015), <https://daily.financialexecutives.org/privately-held-family-owned-businesses-independent-boards-directors>.

15. See, e.g., *Roach v. Bynum*, 403 So. 2d 187, 188-91 (Ala. 1981) (noting that bylaw super-majority voting requirements facilitated hopeless deadlock); *Mordka v. Mordka Enters., Inc.*, 693 P.2d 953, 960 (Ariz. Ct. App. 1984) (describing how unanimous voting requirement over major corporate decisions led to deadlock).

upon which a shareholder may petition a court for equitable relief.<sup>16</sup> This legislative authorization is hardly unique—as other state corporation laws enable shareholders to pursue relief for deadlock.<sup>17</sup> If a shareholder in an Illinois corporation brings a suit based on director deadlock, the following outline best summarizes the elements she must prove under section 12.56(a)(1):

- (1) the directors are deadlocked in the management of the corporate affairs;
- (2) the shareholders are unable to break the deadlock; and (3) *either*:
  - (a) actual or threatened irreparable injury to the corporation, *or*
  - (b) the business of the corporation no longer can be conducted to the general advantage of the shareholders.<sup>18</sup>

In a firm where management and ownership are symmetrical, the shareholders' ability to break a deadlock (element 2) is not a genuine point of contest. Therefore, deadlock cases usually revolve around two questions.

16. 805 ILL. COMP. STAT. 5/12.56(a)(1) (2017).

17. ALA. CODE § 10A-2-14.30(2)(i) (2017); ALASKA STAT. § 10.06.628(b)(2)-(3) (2016); ARIZ. REV. STAT. § 10-1430(B)(1) (LexisNexis 2017); ARK. CODE ANN. § 4-27-1430(2)(i) (2016); CAL. CORP. CODE § 1800(b)(2)-(3) (Deering 2017); COLO. REV. STAT. § 7-114-301(2)(a) (2017); CONN. GEN. STAT. § 33-896(a)(1) (2016); DEL. CODE ANN. tit. 8, § 226(a)(2) (2016); D.C. CODE § 29-312.20(a)(2) (2017); FLA. STAT. § 607.1430(2)(a) (2017); GA. CODE ANN. § 14-2-1430(2)(A) (2016); HAW. REV. STAT. § 414-411(2)(A) (2017); IDAHO CODE ANN. § 30-29-1430(2)(a) (2016); IND. CODE § 23-1-47-1(2)(A) (2016); IOWA CODE § 490.1430(2)(a) (2016); KAN. STAT. ANN. § 17-6804(d) (2016); KY. REV. STAT. ANN. § 271B.14-300(2)(a) (LexisNexis 2016); LA. STAT. ANN. § 12:1-1430(A)(2)(a) (2017); ME. REV. STAT. ANN. tit. 13-C, § 1430(2)(A) (2016); MD. CODE ANN., CORPS. & ASS'NS § 3-413(a)(1) (LexisNexis 2016); MASS. GEN. LAWS ch. 156D, § 14.30(2)(i) (2016); MICH. COMP. LAWS § 450.1823(a) (2016); MINN. STAT. § 302A.751(b)(1) (2017); MISS. CODE ANN. § 79-4-14.30(2)(i) (2016); MO. REV. STAT. § 351.494(2)(a) (2017); MONT. CODE ANN. § 35-1-938(2)(a) (2015); NEB. REV. STAT. § 21-2,197(a)(2)(i)(A) (2016); NEV. REV. STAT. § 78.650(1)(d) (2015); N.H. REV. STAT. ANN. § 293-A:14.30(2)(i) (2017); N.J. STAT. ANN. § 14A:12-7(1)(b) (West 2016); N.M. STAT. ANN. § 53-16-16(A)(1)(a) (2016); N.Y. BUS. CORP. LAW § 1104(a)(1) (McKinney 2016); N.C. GEN. STAT. § 55-14-30(2)(i) (2016); N.D. CENT. CODE § 10-19.1-115(2)(b)(1) (2017); OHIO REV. CODE ANN. § 1701.91(A)(4) (LexisNexis 2017); OKLA. STAT. tit. 18, § 1094 (2016); OR. REV. STAT. § 60.661(2)(a) (2015); 15 PA. CONS. STAT. § 1981(a)(3) (2016); 7 R.I. GEN. LAWS § 7-1.2-1314(a)(1)(i) (2017); S.C. CODE ANN. § 33-14-300(2)(i) (2016); S.D. CODIFIED LAWS § 47-1A-1430(2)(a) (2016); TENN. CODE ANN. § 48-24-301(2)(A) (2016); TEX. BUS. ORG. CODE ANN. § 11.404(a)(1)(B) (West 2015); UTAH CODE ANN. § 16-10a-1430(2)(a) (LexisNexis 2017); VT. STAT. ANN. tit. 11A, § 14.30(2)(A) (2016); VA. CODE ANN. § 13.1-747(A)(1)(a) (2017); WASH. REV. CODE § 23B.14.300(2)(a) (2016); W. VA. CODE § 31D-14-1430(2)(A) (2016); WIS. STAT. § 180.1430(2)(A) (2017); WYO. STAT. ANN. § 17-16-1430(a)(ii)(A) (2016).

18. 805 ILL. COMP. STAT. 5/12.56(a)(1) (2017).

First, are management difficulties so acute as to constitute true organizational deadlock? Second, how does deadlock impact the shareholders collectively or the corporation's going-concern value?

*A. Paralyzing Disagreement or Mere Dissension: A Study in Pragmatism*

Since the BCA provides no definitional help, it is appropriate to look to the plain meaning of the term "deadlock" and interpretive cases.<sup>19</sup> In Illinois, the starting point is *Callier v. Callier*, where the appellate court looked to the dictionary definition of deadlock.<sup>20</sup> *Callier* found that it means "[a] counteraction of things producing entire stoppage; hence, a state of inaction or of neutralization caused by the opposition of persons or factions, as in a government or in a voting body."<sup>21</sup> The dictionary definition, though, lacks context and provides little help to practitioners. Resorting to other judicial decisions yields some illustrative cases, but no bright-line rules.

The Supreme Court of Alabama has used colorful phrases to suggest a petitioning shareholder bears a heavy burden to show deadlock. In particular, it describes deadlock as the "paralysis of corporate function" and an entity that is "impotent and unable to legally transact any business on account of the controversy and ill feeling existing between [the shareholders]."<sup>22</sup> A standard that examines whether a company is unable to transact business is surely the strictest possible deadlock formula. The Court of Appeals of Oregon took a similar, but likely more flexible, approach when it framed deadlock as the "inaction which results when two equally powerful factions stake out opposing positions and refuse to budge."<sup>23</sup> The most reliable definition of deadlock may come from Delaware, which requires the directors to be "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."<sup>24</sup>

Regardless of these judicially crafted standards, the meaning of deadlock is entirely contextual. In closely-held corporations, disagreements can arise in an endless set of fact patterns.<sup>25</sup> This makes it difficult to establish workable parameters in defining deadlock, other than to say that courts must

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19. See *Rogers v. Imeri*, 999 N.E.2d 340, 343 (Ill. 2013) (stating courts should construe statutes according to intent of legislature, which is best determined through "plain and ordinary meaning").

20. *Callier v. Callier*, 378 N.E.2d 405, 408 (Ill. App. Ct. 1978).

21. *Id.*

22. *Cowin v. Salmon*, 28 So. 2d 633, 636 (Ala. 1946).

23. *Wilcox v. Stiles*, 873 P.2d 1102, 1105 (Or. Ct. App. 1994).

24. DEL. CODE ANN. tit. 8, § 226(a)(2) (2016).

25. See *Galler v. Galler*, 203 N.E.2d 577, 584 (Ill. 1964) ("[A]s in the case at bar, the shareholders of a close corporation are often also the directors and officers . . .").

retain some flexibility in applying the legal standard.<sup>26</sup> A case from the Northern District of Illinois, *Donovan v. Quade*, provides a stark example of deadlock.<sup>27</sup> There, the court found irreconcilable deadlock when the directors operated the company's two separate branches as if they were different businesses, went without meetings, and had disagreements over distribution of profits and royalties.<sup>28</sup> They also lodged competing accusations of forgery, mismanagement, fiduciary-duty violations, and failure to account for profits.<sup>29</sup> By the time of trial, the parties' disagreements and conduct towards each other was so pervasive that there was "no hope" the conduct would ever change.<sup>30</sup> In effect, the directors had disregarded their own corporation, and their disagreements pervaded the entire purpose for which they pooled their trust together in the first place. *Donovan* illustrates that the concept of deadlock must be both forward- and backward-looking. Put differently, a court generally will need to assess the directors' past disputes to determine how likely it is that they can manage a firm in the future, consistent with their fiduciary obligations.<sup>31</sup>

By contrast, mere disagreement or dissension is not deadlock.<sup>32</sup> Unlike the dysfunctional entity in *Donovan*, the New York Court of Appeals addressed the appropriate remedy for a successful, profitable corporation facing internal strife in the widely-cited case of *In re Radom & Neidorff, Inc.*<sup>33</sup> The facts there revealed discord between brother and sister, but no fundamental disagreement over corporate policy. Just as importantly, though, the corporation was highly profitable.<sup>34</sup> In fact, the only real point of dispute between the shareholder-directors seemed to be nonpayment of the petitioner's salary, which the court of appeals found "remediable by means other than dissolution."<sup>35</sup> New York's General Corporation Law allowed for dissolution based on deadlock, but it did not enable a court to order other forms of equitable relief. To sustain a finding of deadlock, the petitioning shareholder had to

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26. Cf. *Ski Roundtop, Inc. v. Hall*, 658 P.2d 1071, 1080 (Mont. 1983) (stating that in cases of shareholder oppression, the legal standard must retain "useful flexibility").

27. *Donovan v. Quade*, 830 F. Supp. 2d 460 (N.D. Ill. 2011).

28. *Id.* at 487-88.

29. *Id.*

30. *Id.* at 488.

31. See *Anest v. Audino*, 773 N.E.2d 202, 209 (Ill. App. Ct. 2002) (noting that individuals who control corporations owe a fiduciary duty to their corporations and their shareholders).

32. See *Renbaum v. Custom Holding, Inc.*, 871 A.2d 554, 572 (Md. 2005) ("When dissension is serious enough to reach the stage of deadlock, then a court has the discretion to order dissolution based on an appropriate evidentiary showing . . .").

33. *In re Radom & Neidorff, Inc.*, 119 N.E.2d 563 (N.Y. 1954).

34. *Id.* at 564.

35. *Id.* at 564-65.



show the parties' competing interests were "so discordant as to prevent efficient management," and that the "object of its corporate existence cannot be attained."<sup>36</sup> *Radom & Neidorff* sets forth one of the clearest standards for how to determine whether disagreement rises beyond mere dissension to the level of true management deadlock.<sup>37</sup>

Cases from other states illustrate how shareholders can satisfy an exacting deadlock standard. In *Handlan v. Handlan*, the Supreme Court of Missouri found an obvious case of deadlock when the evenly-divided directors had "violent disagreement as to business policies and methods."<sup>38</sup> The court specifically noted that each director "ignored the other in the management of the business and made decisions" without consulting the other.<sup>39</sup> The California Court of Appeal, in *Reynolds v. Special Projects, Inc.*, upheld a finding of deadlock when the directors disagreed over one of the director's diversion of corporate funds for his personal use and over the term of a critical licensing contract.<sup>40</sup> Finally, in *Laskey v. L&L Manchester Drive-In, Inc.*, the Supreme Court of Maine determined that deadlock existed when there were intense disagreements over officer and employee compensation and acrimony between director factions that resulted in a loss of communication.<sup>41</sup>

As these cases suggest, courts are willing to find deadlock in the face of continuous disagreements, high levels of personal animosity, and facts establishing the impairment of core management functions.<sup>42</sup> A number of cases also have found deadlock when directors disagree over whether to sell real estate when the company's *sole* purpose is to manage real estate.<sup>43</sup> This limited-purpose entity seems well-suited for a deadlock analysis because of the

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36. *Id.* at 565 (quoting *Hitch v. Hawley*, 30 N.E. 401, 404 (N.Y. 1892)).

37. For an example of a case where ancillary disputes among managers do not equate to deadlock, see *Freedman v. Fox*, 67 So. 2d 692, 693 (Fla. 1953) (disputes in corporation that owned hotel involved refusal to repair television sets, disruption of guests' enjoyment, and failing to throw holiday parties).

38. *Handlan v. Handlan*, 232 S.W.2d 944, 951 (Mo. 1950).

39. *Id.*

40. *Reynolds v. Special Projects, Inc.*, 260 Cal. App. 2d 496, 501 (Cal. Ct. App. 2d Dist. 1968).

41. *Laskey v. L&L Manchester Drive-In, Inc.*, 216 A.2d 310, 316-17 (Me. 1966); see also *In re Dissolution of T.J. Ronan Paint Corp.*, 469 N.Y.S.2d 931, 936 (N.Y. App. Div. 1984) (finding deadlock when there was "intense personal hostility [which posed] an irreconcilable barrier to the continued functioning and prosperity of the corporation").

42. See also *Ward v. Ward Farms, Inc.*, 324 S.E.2d 63, 64 (S.C. 1984) (noting director obtained court order barring other director from entering corporate property); *Leck v. Pugh*, 676 S.W.2d 180 (Tex. Civ. App. 1984) (noting equal owners of firm engaged in continual litigation against each other).

43. *Fernandez v. Yates*, 145 So. 3d 141 (Fla. Dist. Ct. App. 2014); *Gillingham v. Swan Falls Land & Cattle Co.*, 683 P.2d 895 (Idaho Ct. App. 1984).

narrow substantive topics on which a shareholder must show director disagreement. Once again, though, the fact-specific nature of these disputes tempers the importance of any one reported deadlock case.<sup>44</sup>

These cases lead to an intuitive conclusion: the meaning of deadlock is pragmatic, not formalist. A court hearing a shareholder petition based on deadlock must engage with the facts pragmatically to conclude whether the directors merely disagree on some aspects of the business or cannot work together cooperatively on major decisions affecting the firm's strategic plans and overall mission.<sup>45</sup> But given the almost infinite number of fact patterns that can arise in disputes between owner-managers, it is impossible to establish bright-line rules concerning what activity rises to the level of deadlock.<sup>46</sup>

### B. *Self-Dealing: Recasting Deadlock as Oppression*

Good-faith disagreements, or even personal animosity between directors, stand in sharp contrast to outright self-dealing and breach of fiduciary duty.<sup>47</sup> On this score, *Gidwitz v. Lanzit Corrugated Box Co.* establishes that courts will not hesitate to remediate self-dealing when one director uses deadlock to assert control over the company.<sup>48</sup> In that case, the president of the corporation—aligned with one fifty-percent shareholder bloc—effectively controlled the company's day-to-day decisions by ignoring the bylaws, refusing to call meetings, and profiting at the corporation's expense.<sup>49</sup> The case contains no expansive deadlock analysis; in effect, the Supreme Court of Illinois implicitly transformed a deadlock case into one of oppression (now a

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44. Appellate courts often discuss deadlock cases under a highly deferential standard of review, which results in decisions that are of little guidance to practitioners. *See, e.g.,* *Levine v. Beem*, 608 So. 2d 373 (Ala. 1992); *Anderson v. Kinser*, 173 N.E.2d 914 (Ind. 1961); *In re Krewe of Crescent City, Inc.*, 532 So. 2d 897 (La. Ct. App. 1988).

45. *See* *Hall v. Woods*, 156 N.E. 258, 267 (Ill. 1927) (stating that it is “within the power and the duty of the board of directors to control the affairs of the corporation, to fix the duties of its officers and employees, to adopt by-laws, and to manage the corporate property and business for the benefit of all the stockholders.”).

46. *See* Mary Schenk, *Judge Orders Investment Firm Dissolved*, NEWS-GAZETTE (Sept. 5, 2014, 9:19 PM), <http://www.news-gazette.com/news/local/2014-09-05/judge-orders-investment-firm-dissolved.html> (discussing judgment of dissolution under section 12.56 which arose out of one director's separate meritless lawsuit against another director based on false allegations of breach of fiduciary duty, fraud, and embezzlement).

47. *See* *Johnson v. Cent. Standard Life Ins. Co.*, 243 N.E.2d 376, 382-83 (Ill. App. Ct. 1968) (discussing fiduciary obligations of corporate directors).

48. *Gidwitz v. Lanzit Corrugated Box Co.*, 170 N.E.2d 131, 138 (Ill. 1960) (affirming decree of dissolution); *see also* *Bowen v. Bowen-Romer Flour Mills Corp.*, 217 P. 301, 303 (Kan. 1923) (stating that in an equally divided firm, “[o]ne group of belligerents has possession of the corporate property and control of its business affairs, and is taking advantage of the opportunity to oppress the other group.”).

49. *Gidwitz*, 170 N.E.2d at 138.

separate basis for shareholder relief under section 12.56) given the president's blanket assertion of control and his resultant self-dealing.<sup>50</sup> Ultimately, the court found dissolution—the only remedy allowed under the law at the time—was appropriate.<sup>51</sup>

Directors sometimes feign deadlock for a tactical advantage. A shareholder-director may feel she is locked into a long-term partnership with someone she no longer trusts. Or she may believe better opportunities lie elsewhere. A poorly-constructed shareholder agreement may complicate any exit strategy and encourage false claims of deadlock. Illinois appellate courts have addressed these feigned deadlocks twice, in *Callier v. Callier*<sup>52</sup> and *Smith-Shrader Co. v. Smith*.<sup>53</sup>

The court in *Callier* found no deadlock when two equal shareholders were unable to agree upon whether to dissolve the corporation voluntarily or to have one owner buy out the other.<sup>54</sup> The court's determination that no deadlock existed, however, likely was a product of the petitioning shareholder's unilateral decision to shut down the business, siphon off all employees and customers, and effectively terminate the operations of a profitable enterprise.<sup>55</sup> Calling this a "flagrant breach of [the director's] fiduciary duty," the court would not reward the plaintiff with a finding of deadlock.<sup>56</sup> A similar result followed in *Smith-Shrader*, which involved one fifty-percent shareholder's improper pre-termination competition with his own company.<sup>57</sup> The court, relying on *Callier*, noted the "manifest unfairness of allowing Smith, who breached his fiduciary duty to S-S, to force dissolution of what is remaining of S-S."<sup>58</sup> Without even discussing the trial court's sweeping grant of injunctive relief, the appellate court affirmed a nine-year, customer-based injunction against Smith.<sup>59</sup>

*Callier* and *Smith-Shrader* are cases of artificial deadlock stemming from oppression and breach of fiduciary duty. Indeed, feigned deadlock for individual advantage presumptively should rise to the level of oppressive behavior, which provides a shareholder an independent basis for invoking section 12.56.<sup>60</sup> A shareholder's claim for breach of fiduciary duty is a close cousin of oppression; though depending on the facts, the action may belong

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50. *Id.*

51. *Id.*

52. *Callier v. Callier*, 378 N.E.2d 405 (Ill. App. Ct. 1978).

53. *Smith-Shrader Co. v. Smith*, 483 N.E.2d 283 (Ill. App. Ct. 1985).

54. *Callier*, 378 N.E.2d at 408-09.

55. *Id.* at 407-08.

56. *Id.*; *cf. Lien v. Lien*, 674 N.W.2d 816, 823-24 (S.D. 2004) (holding that shareholder could not create deadlock artificially by refusing to attend meetings).

57. *Smith-Shrader*, 483 N.E.2d at 291.

58. *Id.*

59. *Id.* at 285.

60. 805 ILL. COMP. STAT. 5/12.56(a)(3) (2017).

to the firm and not the shareholder.<sup>61</sup> If a shareholder establishes self-dealing through a fiduciary duty claim, a court is likely to find that this is indeed a *derivative* action.<sup>62</sup> Section 12.56, however, is an express grant of authority for a shareholder to bring an *individual* action, and she may wish to avoid the procedural nuances of pursuing a derivative claim.<sup>63</sup> Equating a fiduciary breach to oppression, and proceeding directly, seems the better route for shareholders to take.<sup>64</sup>

Deadlock and oppression claims also differ qualitatively. On the one hand, conduct resulting in deadlock is not necessarily wrongful.<sup>65</sup> A court may order relief even if it finds both sides share blame.<sup>66</sup> Oppression, though, is of a different ilk. An oppression claim connotes heavy-handed conduct by one party against another, even if the conduct stops short of outright fraud.<sup>67</sup> In the proper case, it can lead to collateral remedies such as an award of damages or fee-shifting.<sup>68</sup> Opportunistic behavior by a business partner suggests an oppression action, rather than one for deadlock, is the optimal path to choose, if for no other reason than it avoids heightened proof of corporate injury.<sup>69</sup>

Cases of feigned deadlock, such as *Callier* and *Smith-Shrader*, illustrate that Illinois courts are capable of making this distinction. Those cases also

61. See *Frank v. Hadesman & Frank, Inc.*, 83 F.3d 158, 160 (7th Cir. 1996) (“Illinois follows the widespread rule that an action for harm to the corporation must be brought in the corporate name. When investors have been injured in common, they must continue to act through their collective—the corporation.”).

62. See *Small v. Sussman*, 713 N.E.2d 1216, 1220 (Ill. App. Ct. 1999) (describing division of business to other entity a “classic injury to the corporation”).

63. See *Borgsmiller v. Burroughs*, 542 N.E.2d 1281, 1286 (Ill. App. Ct. 1989) (providing that shareholders may bring derivative suit only if they first demand that directors bring action, unless they plead that “directors sought to be sued are in control of the corporation”).

64. Several courts analyze the concept of “oppression” with specific reference to prevailing fiduciary-duty rules that the corporation or the majority shareholders owe to a minority partner. See *Whale Art Co. v. Docter*, 743 S.W.2d 511, 514 (Mo. Ct. App. 1987); *Davis v. Brockamp & Jaeger, Inc.*, 174 P.3d 607, 614 (Or. Ct. App. 2007).

65. See *In re Goodman v. Lovett*, 607 N.Y.S.2d 52, 53 (N.Y. App. Div. 1994) (stating that underlying cause of deadlock “is of no moment, nor is it at all relevant to ascribe fault to either party”).

66. See *Donovan v. Quade*, 830 F. Supp. 2d 460, 487-88 (N.D. Ill. 2011).

67. See *Compton v. Paul K. Harding Realty Co.*, 285 N.E.2d 574, 581 (Ill. App. Ct. 1972) (noting “oppression” is not synonymous with illegal or fraudulent activity and assessing instead whether evidence showed “arbitrary, overbearing and heavy-handed course of conduct”).

68. 805 ILL. COMP. STAT. 5/12.56(b)(10) (2017) (damages remedy); 805 ILL. COMP. STAT. 5/12.60(j) (2017) (legal fees available if party acts “arbitrarily, vexatiously, or otherwise not in good faith”).

69. See *infra* text accompanying notes 74-100.

stand for the broader principle that deadlock should be difficult for any shareholder to establish. Lax deadlock standards lead to more claims and incent directors to act selfishly.<sup>70</sup> Because principals of a closely-held corporation have most of their investable assets tied up in their firm, they are more inclined to use aggressive tactics to protect their own interests.<sup>71</sup> A rigorous legal standard enables courts to ensure one director is not taking advantage of another for the purposes of creating deadlock.<sup>72</sup> The oppression standard and even default fiduciary duty rules temper the deadlock analysis, providing an aggrieved and innocent shareholder a different and easier path to equitable relief.<sup>73</sup>

### C. *The Injury Requirement: Irreparable Harm and Beyond*

Deadlock and oppression claims differ for another equally significant reason: the burden of proof is drastically higher when a shareholder brings a deadlock action. A petitioning shareholder's proof of pervasive internal strife, by itself, is insufficient. That showing must further convince a court that serious harm has resulted, or inevitably will result, to the shareholders collectively or to the entity as a going concern.<sup>74</sup>

A garden-variety oppression complaint may have nothing to do with harm to the corporation.<sup>75</sup> By definition, it is an individualized claim.<sup>76</sup> However, a deadlock case demands a rigorous analysis of *corporate* harm.<sup>77</sup> The BCA incorporates this standard by requiring a shareholder to prove either irreparable injury or that the corporation cannot carry on its affairs to the

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70. See Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 287 (1986) (discussing why directors should draft corporate contracts to make dissolution more difficult to achieve).

71. See Frank H. Easterbrook & Daniel R. Fischel, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 229-30 (1991).

72. *Id.*

73. See *Hagshenas v. Gaylord*, 557 N.E.2d 316, 321-23 (Ill. App. Ct. 1990) (analogizing fiduciary duties of major shareholders in closely-held corporation to those owed by partners).

74. See Charles W. Murdock, *Evolution of Effective Remedies for Minority Shareholders and Its Impact Upon Valuation of Minority Shares*, 65 NOTRE DAME L. REV. 425, 454 (1990) (discussing need to show harm to the corporation and its going-concern value under "irreparable injury" prong).

75. See *Cent. Standard Life Ins. Co. v. Davis*, 141 N.E.2d 45, 51 (Ill. 1957) (rejecting argument that oppression is synonymous with illegal or fraudulent and stating that "[m]isapplication of assets or mismanagement of funds are not, as we read the statute, indispensable ingredients of 'oppressive' conduct.>").

76. *Ritchie v. Rupe*, 443 S.W.3d 856, 870 (Tex. 2014); *N. Air Servs. v. Link*, 804 N.W.2d 458, 478 (Wis. 2011).

77. *TransPerfect Glob., Inc. v. Elting (In re Shawe & Elting, LLC)*, C.A. No. 9661-CB, 2015 WL 4874733, at \*26-30 (Del. Ch. Aug. 13, 2015), *aff'd*, 157 A.3d 152 (Del. 2017).

general advantage of the shareholders.<sup>78</sup> Under either prong, a court must examine deadlock's impact.<sup>79</sup> A showing of injury to a particular shareholder is not enough, though courts sometimes get it wrong.<sup>80</sup>

The most logical starting place for deciphering what constitutes irreparable injury is the standard for obtaining injunctive relief. Irreparable injury does not mean harm beyond compensation in damages, but rather one that denotes "transgressions of a continuing nature."<sup>81</sup> Courts frequently discuss the concept of irreparable injury by assessing whether a legal remedy is adequate, often merging the two inquiries.<sup>82</sup> A petitioning shareholder likely could show irreparable injury if management deadlock has caused abnormal customer attrition, a failure to renew a favorable supply contract, or the inability to protect valuable intellectual property rights.<sup>83</sup> These intangible injuries could harm a firm's competitive position, its going-concern value, or the delivery of shareholder returns.<sup>84</sup> A court also may find irreparable injury if deadlock leads to the corporation's inability to borrow money, refinance debt obligations, or close the terms of a forbearance agreement.<sup>85</sup>

Some courts have looked beyond these particularized showings of harm and instead have found irreparable injury when the directors are "unable to cooperate in the management of the corporation's business," leaving the application of this general standard to the particular facts of the dispute.<sup>86</sup> As an illustration, a recent case from Delaware involving TransPerfect Global,

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78. 805 ILL. COMP. STAT. 12.56(a)(1) (2017).

79. See *Henry-George & Sons, Inc. v. Cooper-George, Inc.*, 632 P.2d 512, 516-17 (Wash. 1981) (interpreting dissolution statute to require more than jurisdictional facts establishing deadlock; court also must consider "seriousness of the deadlock and whether the corporation is able to conduct business profitably despite the deadlock.").

80. See *Gillingham v. Swan Falls Land & Cattle, Inc.*, 683 P.2d 895, 897 (Idaho Ct. App. 1984) (focusing upon injury to shareholder, not entity).

81. *Victor Twp. Drainage Dist. 1 v. Lundeen Family Farm P'ship*, 19 N.E.3d 652, 666 (Ill. App. Ct. 2014).

82. See *Fleet Wholesale Supply Co. v. Remington Arms Co.*, 846 F.2d 1095, 1098 (7th Cir. 1988) ("To say that [an] injury is irreparable means that the methods of repair (remedies at law) are inadequate."); *Hutter v. Lake View Tr. & Sav. Bank*, 370 N.E.2d 47, 49 (Ill. App. Ct. 1977) ("Irreparable harm is established where the remedy at law is inadequate in that monetary damages either will not adequately compensate plaintiff or cannot be measured by any pecuniary standard.").

83. See, e.g., *Hendley v. Lee*, 676 F. Supp. 1317, 1323 (D. S.C. 1987) (identifying potential for lost customers as a basis for finding that petitioner met deadlock standard under South Carolina statute).

84. See *Prentice Med. Corp. v. Todd*, 495 N.E.2d 1044, 1051 (Ill. App. Ct. 1986) (noting that the concept of irreparable harm contemplates damage to goodwill of a business or loss of competitive position).

85. *Skarbo v. Skarbo Scandinavian Furniture Imp., Inc.*, Nos. 54288-5-I, 54410-5-I, 2005 WL 1950599, at \*6 (Wash. Ct. App. Aug. 15, 2005).

86. *Goldstein v. Studley*, 452 S.W.2d 75, 79-80 (Mo. 1970).

*In re Shawe & Elting*, found management deadlock in a profitable corporation when the directors and co-Chief Executive Officers could not agree on acquisition strategy, as well as hiring and retention of key employees.<sup>87</sup>

If a petitioning shareholder cannot show irreparable harm resulting from management paralysis, she alternatively could illustrate the corporation is unable to conduct business to the shareholders' general advantage.<sup>88</sup> This alternative form of proof stems from the 1984 Model Business Corporation Act, which in theory expanded the bases upon which a shareholder could establish a deadlock claim.<sup>89</sup> Other states have adopted similar shareholder-centric language in their deadlock statutes.<sup>90</sup> A shareholder can satisfy this injury prong by demonstrating the deadlock has allowed one director to assume effective control of the company or sabotage the business, a *Gidwitz*-style analysis.<sup>91</sup> Courts in North Carolina interpret this provision to require a showing "that the business is being conducted to the unfair advantage of one shareholder or group of shareholders, or that a shareholder or group of shareholders is benefitting at the expense of the others."<sup>92</sup> The impact of deadlock on shareholders' ability to receive dividends also may establish that the corporation cannot provide for the shareholders' general advantage. Because shareholders in a closely-held corporation often rely on the firm for salary-like income, deadlock over distributions can undermine one of the primary purposes of the enterprise.<sup>93</sup>

For many courts, the general-advantage language appears to demand a showing that the enterprise is unprofitable.<sup>94</sup> For instance, an old Minnesota

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87. *TransPerfect Glob., Inc. v. Elting (In re Shawe & Elting LLC)*, C.A. No. 9661-CB, 2015 WL 4874733, at \*26-30 (Del. Ch. Aug. 13, 2015), *aff'd*, 157 A.3d 152 (Del. 2017).

88. 805 ILL. COMP. STAT. 5/12.56(a)(1) (2017).

89. MODEL BUS. CORP. ACT § 14.30(2)(1) (1984).

90. *See, e.g.*, ARIZ. REV. STAT. ANN. § 10-1430(B)(1) (2017) (establishing grounds for judicial dissolution); S.C. CODE ANN. § 33-14-300(2)(i) (2016) (same).

91. *See supra* text accompanying notes 48-73; *see also Sartori v. S&S Trucking, Inc.*, 139 P.3d 806, 809 (Mont. 2006).

92. *Foster v. Foster Farms, Inc.*, 436 S.E.2d 843, 848-49 (N.C. Ct. App. 1993); *see also Ellis v. Civic Improvement, Inc.*, 209 S.E.2d 873, 876 (N.C. Ct. App. 1974) (affirming dissolution order when deadlock favored one shareholder over the others). The Supreme Court of South Dakota applied the same analysis in the context of a deadlocked limited liability company. *See Kirksey v. Grohmann*, 754 N.W.2d 825, 831 (S.D. 2008) (two of four LLC members unfairly benefited from lease terms; remanding for entry of dissolution order).

93. *TransPerfect Glob., Inc. v. Elting (In re Shawe & Elting LLC)*, C.A. No. 9661-CB, 2015 WL 4874733, at \*26 (Del. Ch. Aug. 13, 2015), *aff'd*, 157 A.3d 152 (Del. 2017).

94. *See Vander Wall v. Burns*, No. 91 C 4294, 1992 U.S. Dist. LEXIS 13716, at \*20 (N.D. Ill. Sept. 11, 1992) (stating that whether corporation can be conducted to general advantage of the shareholders "turns, primarily, on the profitability of the corporation."); *Enders v. Enders*, 991 N.E.2d 154, 159-60 (Ind. Ct. App. 2013) (affirming decision to dissolve corporation in part because it was no longer profitable); *Blythe v. Blythe*, 870 P.2d 705, 707 (Kan. Ct. App. 1994) (affirming decision not to dissolve ranching operation where equal shareholders had "mere disputes" over profitable business).

deadlock case says the term advantage “connotes elements of opportunity, benefit, or profit, and negatively suggests absence of sacrifice, harm or loss.”<sup>95</sup> This reasoning suggests shareholders could make a convincing case that the business operates to no one’s general advantage if management discord leads to the accumulation of continual operating losses.<sup>96</sup>

The BCA implicitly endorses a more flexible standard, since it provides that a court may not refuse to dissolve a corporation “solely because it has accumulated earnings or current operating profits.”<sup>97</sup> This statutory language softens the general-advantage test used by other courts and enables a petitioning shareholder to meet her burden of proof in ways that are divorced from a profitability analysis. On this score, a petitioning shareholder should be able to argue credibly for relief (including the disfavored remedy of dissolution<sup>98</sup>) by illustrating that the court should impose a remedy before pervasive harm to the entity and the shareholders ensues, provided the prospective harm is factually grounded and not merely speculative. As the Court of Appeals of Kansas has stated, removing the dissolution remedy from the profitable but deadlocked enterprise “would ignore many other potential and serious harms, like lost profits, lost business opportunities, or the failure to realize other common expectations that may have been part of the company’s business plan before the deadlock.”<sup>99</sup> One leading commentator seems to agree that the deadlock question should not hinge on mere corporate solvency.<sup>100</sup>

### III. THE REMEDIAL LIMITATIONS OF SECTION 12.56

Assuming a petitioning shareholder can establish deadlock, the question turns to the appropriate remedy. Some of the remedies available to shareholders under section 12.56 are exceedingly narrow.<sup>101</sup> Others are broad and

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95. Anderson v. Anderson (*In re* Lakeland Dev. Corp.), 152 N.W.2d 758, 767 (Minn. 1967).

96. This approach is consistent with partnership law, which generally recognizes that courts may dissolve partnerships if they only can be continued at a loss. *See* 805 ILL. COMP. STAT. 206/801(5)(i) (2017); Mandell v. Centrum Frontier Corp., 407 N.E.2d 821, 828-29 (Ill. App. Ct. 1980).

97. 805 ILL. COMP. STAT. 5/12.56(b)(12) (2017).

98. *See infra* text accompanying notes 152-67.

99. *In re* Metcalf Assocs.-2000, LLC, 213 P.3d 751, 755 (Kan. Ct. App. 2009).

100. *See* Harry J. Haynsworth, *The Effectiveness of Involuntary Dissolution Suits as a Remedy for Close Corporation Dissension*, 35 CLEV. ST. L. REV. 25, 34 (1987).

101. *See, e.g.*, 805 ILL. COMP. STAT. 5/12.56(b)(1, 5, 8-10) (2017).



sweeping, empowering a court to realign corporate management and ownership.<sup>102</sup> One potential remedy available to petitioning shareholders is judicial dissolution: a court-ordered termination of the company as a legal entity.<sup>103</sup>

By its very text, section 12.56(b)(12) openly discourages involuntary dissolution. The statute allows for dissolution only if the “court determines that no remedy specified in subdivisions (1) through (11) or other alternative remedy is sufficient to resolve the matters in dispute.”<sup>104</sup> This is consistent with the common-law admonition that dissolution is a remedy of last resort.<sup>105</sup> Other states have similar, though inexact, statutory admonitions concerning the dissolution remedy.<sup>106</sup>

#### A. *Section 12.56(b): An Overview*

To gauge the viability of the dissolution remedy, subsection (12) requires a deep analysis of the various alternative forms of relief in a shareholder action. Some of the BCA’s enumerated remedies may apply to deadlock claims, while others plainly do not. Section 12.56’s list of remedies, short of dissolution, includes the following:

- (1) The performance, prohibition, alteration, or setting aside of any action of the corporation or of its shareholders, directors, or officers of or any other party to the proceedings;
- (2) The cancellation or alteration of any provision in the corporation’s articles of incorporation or by-laws;
- (3) The removal from office of any director or officer;
- (4) The appointment of any individual as a director or officer;
- (5) An accounting with respect to any matter in dispute;
- (6) The appointment of a custodian to manage the business and affairs of the corporation to serve for the term and under the conditions prescribed by the court;

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102. See, e.g., 805 ILL. COMP. STAT. 5/12.56(b)(2-4, 6-7) (2017).

103. 805 ILL. COMP. STAT. 5/12.56(b)(12) (2017).

104. *Id.*

105. Schirmer v. Bear, 672 N.E.2d 1171, 1176 (Ill. 1996).

106. See MINN. STAT. § 302A.751 (2017) (stating court “shall consider whether lesser relief” would be “adequate”); MONT. CODE ANN. § 35-1-939 (2015) (enabling the court to order relief other than dissolution if, in its discretion, such other relief would be “appropriate”; listing non-exclusive alternative remedies, including purchase of any shareholder’s equity at fair value).

- (7) The appointment of a provisional director to serve for the term and under the conditions prescribed by the court;
- (8) The submission of the dispute to mediation or other forms of non-binding alternative dispute resolution;
- (9) The payment of dividends;
- (10) The award of damages to any aggrieved party;
- (11) The purchase by the corporation of one or more other shareholders of all, but not less than all, of the shares of the petitioning shareholder for their fair value and on the terms determined under subsection (e)....<sup>107</sup>

The remedies contained in subsections (1), (5), (9), and (10) are simply not applicable to, or are not at all sufficient to resolve, claims of director deadlock. Instead, they are more suited to actions for corporate waste or minority shareholder oppression, the other substantive branches of section 12.56.<sup>108</sup> Subsection (8), authorizing a court to submit a dispute to non-binding mediation, is less of a unique shareholder remedy and rather a reflection of existing judicial authority. Many Illinois circuit courts already have mandatory mediation programs, which include actions filed in chancery court.<sup>109</sup> Despite the fulsome list of remedies courts may consider, only two categories other than dissolution potentially would be appropriate to resolve deadlock claims. Those categories, discussed in the following two sections, concern court-ordered director or custodial appointments and share buy-outs.

### *B. Section 12.56(b) and Managerial Appointments*

Subsections (2), (3), (4), (6), and (7) all contemplate a change in director composition or director function, which in theory could break an impasse between the incumbent, warring directors. Two of these potential remedies contain obvious limitations. A bylaw change to require an odd number of directors (subsection (2)) assumes the shareholders will agree on who should serve. That assumption seems inconsistent with what brought the parties to court in the first place. And, the removal of a director (subsection (3)) only

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107. 805 ILL. COMP. STAT. 5/12.56(b)(1)-(11) (2017).

108. See, e.g., *Bone v. Coyle Mech. Supply, Inc.*, No. 5-15-0117, 2017 WL 2403268, at \*16 (Ill. App. Ct. June 1, 2017) (affirming in part and vacating in part remedies afforded plaintiffs, including damages, for claim of shareholder oppression).

109. See ILL. 18TH JUD. CIR. CT. R. 14.02 (all chancery actions eligible for court-ordered mediation).

provides a temporary solution, since the shareholder who has her director removed (assuming they are not the same person) almost certainly will anoint a figurehead who is just as likely to perpetuate the deadlock.

The remedies provided for in subsections (4), (6), and (7) require a more nuanced analysis to determine their suitability to deadlock claims. Subsection (4) allows a court to appoint a director,<sup>110</sup> while subsections (6) and (7) authorize custodians and provisional directors “to serve for the term.”<sup>111</sup> On its face, each subsection seems to solve the deadlock problem. But the appointment of a director or custodian injects the court into a continuing supervisory role over the corporation.<sup>112</sup> Not only does a judicial appointment create added transaction costs, but it also may prolong a dispute that requires prompt resolution.<sup>113</sup> Just as significantly, court-ordered director appointments undermine the shareholders’ *ex ante* decision to retain full veto authority over the management of the business.<sup>114</sup> The choice among shareholders to retain this veto right (either by virtue of their status as equal shareholders or due to super-majority voting provisions) is not a notional one.<sup>115</sup> Instead, it is implicit in the construction of their planning documents. Court-ordered director and custodial appointments undermine that choice.

Director-appointment remedies also are riddled with practical problems. Illinois law permits a director to resign at any time, meaning even a plenary appointment under subsection (4) is, by definition, tenuous.<sup>116</sup> The provisional-director remedy (subsection (7)) is particularly problematic because such an appointment renders the chosen director “an officer of the court.”<sup>117</sup> The same language appears in subsection (6) with regard to appointed “custodians,” which means courts are sure to vest them with officer status too.<sup>118</sup>

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110. 805 ILL. COMP. STAT. 5/12.56(b)(4) (2017).

111. 805 ILL. COMP. STAT. 5/12.56(b)(6)-(7) (2017).

112. See *TransPerfect Glob., Inc. v. Elting (In re Shawe & Elting LLC)*, C.A. No. 9661-CB, 2015 WL 4874733, at \*26 (Del. Ch. Aug. 13, 2015) (noting option under section 226 of Delaware General Corporation Law to appoint “custodian to serve as a third director or some form of tie-breaking mechanism in the governance of the Company” but rejecting it as unwieldy), *aff’d*, 157 A.3d 152 (Del. 2017).

113. See Susanna M. Kim, *The Provisional Director Remedy for Corporate Deadlock: A Proposed Model Statute*, 60 WASH. & LEE L. REV. 111, 137-44 (2003).

114. *Id.* at 138, 142.

115. See *Israels*, *supra* note 13, at 793.

116. 805 ILL. COMP. STAT. 5/8.10(g) (2017) (“A director may resign at any time by giving written notice to the board of directors, its chairman, or to the president or secretary of the corporation.”). Standard bylaws frequently parrot this language.

117. *Abreu ex rel. Ebro Foods v. Unica Indus. Sales, Inc.*, 586 N.E.2d 661, 667 (Ill. App. Ct. 1991).

118. 805 ILL. COMP. STAT. 5/12.56(b)(6) (2017).

Despite receiving this quasi-judicial status, a provisional director or custodian does not have to be impartial.<sup>119</sup> Illinois law is also silent on whether provisional directors or custodians owe fiduciary duties to the corporation, are vested with the same powers as conventionally-elected directors, or are able to avail themselves of the business-judgment rule.

Given this uncertainty, counsel should assume the role of a provisional director or custodian is strictly circumscribed by the court, particularly given other states' laws that suggest a role more sweeping in scope.<sup>120</sup> Furthermore, provisional-director and custodial appointments only can extend "for the term," implying a temporally limited role designed to break a deadlock on imminent managerial decisions affecting a limited class of subjects.<sup>121</sup> To that end, any appointment would invite another round of remedial choices and even more judicial oversight into the corporation's ongoing affairs.

One specific point on custodian appointments is worth mentioning. By its plain language, subsection (6) does not contemplate that a custodian has any authority to sell or auction off the business. Rather, the custodian provision allows a court-appointed officer to "manage the business and affairs of the corporation."<sup>122</sup> This remedial language is different and more restrictive than section 226 of the Delaware General Corporation Law, which authorizes custodial appointments in the face of deadlock.<sup>123</sup> Under Delaware law, a custodian must "continue the business of the corporation," but section 226(b) allows a court to "otherwise order" the scope of the custodian's powers.<sup>124</sup> Delaware courts have interpreted section 226 to allow custodians to sell the deadlocked firm as a going-concern in "unusual" cases.<sup>125</sup> Textually, the custodial remedy in section 12.56 is narrower and does not suggest that the power extends to auctioning off the business.<sup>126</sup> A long-term solution, rather

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119. *Abreu*, 586 N.E.2d at 665. *Contra* ALASKA STAT. § 10.06.640(b) (2016) (requiring impartial provisional director).

120. *See, e.g.*, WIS. STAT. § 180.1833(2)(a)(7) (2017) (for statutory close corporation, stating that a provisional director shall have "all of the rights, powers and duties of a duly elected director . . .").

121. 805 ILL. COMP. STAT. 5/12.56(b)(6)-(7) (2017).

122. 805 ILL. COMP. STAT. 5/12.56(b)(6) (2017).

123. DEL. CODE tit. 8, § 226(a)-(b) (2016).

124. DEL. CODE tit. 8, § 226(b) (2016).

125. *See, e.g.*, *TransPerfect Glob., Inc. v. Elting (In re Shawe & Elting LLC)*, C.A. No. 9661-CB, 2015 WL 4874733, at \*32 (Del. Ch. Aug. 13, 2015) (ordering custodian to report on viability of sale limited to two existing owners of deadlocked corporation, or some other process including an "open auction"), *aff'd*, 157 A.3d 152 (Del. 2017); *Bentas v. Haseotes*, No. Civ.A. 17223 NC, 2003 WL 1711856, at \*4 (Del. Ch. Mar. 31, 2003) (granting motion to auction business in deadlock case).

126. One potential exception is the Court's ability to award "other legal and equitable remedies which the court may impose." 805 ILL. COMP. STAT. 5/12.56(c) (2017). No reported case discusses the possibility of a court-ordered sale or just what types of remedies this statutory provision may allow. However, the share-purchase remedy, discussed at length below,

than interim, court-appointed tie-breakers, is what a deadlocked firm needs.<sup>127</sup>

Even if a court considers a director or custodial appointment a viable solution for deadlock, it would need to identify a qualified third-party and then gauge that individual's interest in serving a corporation with management embroiled in litigation.<sup>128</sup> Courts naturally should be reluctant to inject a third-party into this combustible situation involuntarily.<sup>129</sup> Above all, the procedural remedies in subsections (4), (6), and (7) are unlikely to cure a deadlocked firm. Just as critically, none of those remedies are consistent with the principle that shareholders should be given the freedom to arrange their contractual affairs as they see fit—even if those arrangements are incomplete, misguided, and designed to foster deadlock.<sup>130</sup>

That leaves subsection (11) and the possibility of a court-ordered buy-out of the petitioner's equity. That remedy, though, is fraught with procedural and decisional complexity.

### C. *Section 12.56 and the Share-Purchase Remedy*

A buy-out of a petitioning shareholder would seem to resolve deadlock and foster corporate continuity.<sup>131</sup> Upon a finding that the directors are paralyzed in a firm's management, a court necessarily must determine that those directors are incapable of working together for the betterment of the corporation as a whole.<sup>132</sup> Just as significantly, this finding means the corporation's expected going-concern value will decrease if the two directors are forced to remain together indefinitely; the injury prong of a section 12.56(a)(1) claim

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appears to limit the auction remedy since no court can force a petitioner to sell her shares. See *infra* text accompanying notes 134-49.

127. See Kim, *supra* note 113, at 136 ("If the parties have become completely incompatible, the appointment of a provisional director may be futile and may only delay the inevitable break-up of the company.").

128. See *Abreu ex rel. Ebro Foods v. Unica Indus. Sales, Inc.*, 586 N.E.2d 661, 665 (Ill. App. Ct. 1991) (listing, without citation to any authority, particular qualifications that trial court "may balance in evaluating candidates for provisional director").

129. See *In re O'Brien Mach., Inc.*, 36 Cal. Rptr. 782, 784 (Cal. Dist. Ct. App. 1964) (noting provisional director petitioned court to be relieved after one year in office because he was "frustrated by his inability to effect a termination of the dissension").

130. See Larry E. Ribstein, *The Closely Held Firm: A View from the United States*, 19 MELB. U. L. REV. 950, 955 (1994) ("[J]udicially-administered remedies threaten the security of the agreements the parties have made").

131. See Bruce C. Young & Hugh H. Makens, *War and Pieces: The Impact of Deadlock in the Michigan Closely Held Corporation*, 42 WAYNE L. REV. 1863 (1996) (stating that the "most obvious solution to deadlock is a buyout"). The Delaware General Corporation Law takes a different approach, allowing courts to use its custodial power under section 226 to foster a sale of the business as a going-concern. See *supra* text accompanying notes 122-26.

132. See, e.g., *Donovan v. Quade*, 830 F. Supp. 2d 460, 487-88 (N.D. Ill. 2011).

demands such a finding by the court.<sup>133</sup> Although a buy-out may be the logical means to resolve a deadlock between owner-operators of a closely-held firm, Illinois law limits that remedy more than many would like to believe.

### 1. *The Share-Purchase Remedy's (Short) History*

The share-purchase remedy in subsection (11) is somewhat new, as shareholders in closely-held corporations did not have the option to ask a court to order buy-out relief until 1995.<sup>134</sup> Facilitating the sale of a petitioning shareholder's equity is a remedy that is now a common feature of other state corporation statutes, though the grounds for obtaining a buy-out are hardly uniform.<sup>135</sup> Even without an express legislative grant of authority, some courts were ordering this relief on pure equitable grounds.<sup>136</sup>

As it currently stands, section 12.56(f) governs the specific procedure associated with the purchase of a petitioning party's stock in a closely-held corporation. It provides:

*When the relief requested by the petition includes the purchase of the petitioner's shares, then at any time within 90 days after the filing of the petition under this Section, or at such time determined by the court to be equitable, the corporation or one or more shareholders may elect to purchase all, but not less than all, of the shares owned by the petitioning shareholder for their fair value.*<sup>137</sup>

The General Assembly amended the BCA in 2005 to add the italicized language concerning buy-out relief.<sup>138</sup> By its plain language, section 12.56 does *not* allow a defendant to force a buy-out of the petitioning party's shares

133. See Murdock, *supra* note 74, at 454.

134. See William R. Quinlan & John F. Kennedy, *The Rights and Remedies of Shareholders in Closely Held Corporations Under Illinois Law*, 29 LOY. U. CHI. L. J. 585, 607-12 (1998) (discussing history of General Assembly's amendments to Business Corporation Act of 1983, resulting in enactment of section 12.56).

135. See, e.g., MICH. COMP. LAWS § 450.1489 (2016) (allowing court to order purchase of shares at fair value if petitioner establishes oppression); MINN. STAT. § 302A.751 (Subd. 2) (2017) (authorizing purchase of shares if petitioner establishes deadlock, waste, or oppression).

136. See *Sauer v. Moffitt*, 363 N.W.2d 269, 274-75 (Iowa Ct. App. 1984) (in oppression and waste suit, relying on Oregon case of *Baker v. Commercial Body Builders, Inc.*, 507 P.2d 387 (Or. 1973), to find that trial court could order a "partial liquidation and redemption of the plaintiffs' shares").

137. 805 ILL. COMP. STAT. 5/12.56(f) (2017) (emphasis added).

138. Business Corporation Act of 1983, Pub. Act 94-394, 2005 Ill. Laws 394 (codified as amended at 805 Ill. Comp. Stat. 5/12.56).

unless the petitioner asks for it first.<sup>139</sup> This confirms Illinois' reputation as a pro-shareholder state.<sup>140</sup>

The law before 2005 discouraged a shareholder with a legitimate complaint from seeking judicial remedies. The unfettered ability of the responding shareholder to purchase the petitioner's shares, even if that shareholder intended to remain involved with the corporation, incentivized self-dealing. Put another way, if the responding shareholder (assume he truly is a wrongdoer) determined that the cost of violating his fiduciary duty was less than the expected gain from buying out his partner, then section 12.56 enabled that shareholder to obtain a windfall from his wrongful behavior. As long as the responding party acted within ninety days of the petitioner's lawsuit, he had a call right on his partner's equity interest—even if that partner did not want to sell. The share-purchase remedy, as it existed for nearly a decade, was structurally deficient, which may account for the low volume of reported section 12.56 cases.

## 2. *The Share-Purchase Remedy and Its Perceived Ambiguity*

Some commentators have suggested, in voicing their displeasure with the 2005 amendments to section 12.56, that an involuntary buy-out of a petitioning shareholder still may be available.<sup>141</sup> This idea springs from the enabling language in subsection (11) that a court may order “[t]he purchase by the corporation or one or more other shareholders of all, but not less than all, of the shares of the petitioning shareholder for their fair value . . . .”<sup>142</sup> Under this theory, a plenary grant of authority under subsection (11) means that a corporation or shareholder group can call a petitioner's shares, even if she does not want to sell.

No court has addressed this argument—at least not directly. *Witters v. Hicks* is the only Illinois case that comes close to doing so.<sup>143</sup> In the defendant's first appeal, the appellate court examined his effort to buy out the petitioning party's shares.<sup>144</sup> The buy-out remedy was not available to Hicks because he missed the ninety-day election deadline under section 12.56(f).<sup>145</sup>

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139. 805 ILL. COMP. STAT. 5/12.56(f) (2017).

140. Charles W. Murdock, *Squeeze-Outs, Freeze-Outs, and Discounts: Why is Illinois in the Minority in Protecting Shareholder Interests?*, 35 LOY. U. CHI. L. J. 737, 737 (2004).

141. See Lynn A. Ellenberger, *The Illinois Legislature Overcorrected Section 12.56(f) of the Illinois Business Corporation Act's Forced Buy-Out Provision for Close Corporations*, COUNSELOR (Ill. State Bar. Ass'n Section on Bus. Advice & Fin. Planning Newsletter, Springfield, Ill.), Feb. 2008.

142. 805 ILL. COMP. STAT. 5/12.56(b)(11) (2017).

143. *Witters v. Hicks*, 780 N.E.2d 713 (Ill. App. Ct. 2002).

144. *Id.* at 721-23.

145. *Id.* at 722.

The reasoning suggests a narrow reading of the share-purchase remedy. Importantly, since *Witters v. Hicks*, the General Assembly made it *more* favorable to petitioning shareholders. In this respect, a defendant still must make the election promptly—that is, within the same ninety-day window from the case-filing date—and may do so only if the petitioner asks in her complaint to be bought out.<sup>146</sup> In effect, the General Assembly has made a clear and deliberate policy choice to place control of the buy-out remedy firmly in the petitioning shareholder's hands. Adopting the position that section 12.56(b)(11) allows for an involuntary share-purchase would reverse this policy choice and render section 12.56(f) meaningless.

It would be incongruous and absurd to read section 12.56 as allowing a truly involuntary, forced purchase of equity when subsection (f) contains detailed procedural requirements to enhance protections for the petitioning party.<sup>147</sup> To harmonize the statute, which is a patchwork of legislative amendments, section 12.56(b)(11) reasonably can be read to *include* a properly requested buy-out remedy by the petitioning shareholder as the appropriate relief a “court may order” once she proves a substantive claim under section (a). It goes no further.

A court hearing a section 12.56 case, therefore, cannot force a shareholder to sell her shares, unless she asks to be bought-out, or unless she agrees to be bought-out in the corporate planning documents upon the filing of a dissolution action. This feature of section 12.56 is by no means uniform when measured against similar statutes or rules in other states.<sup>148</sup> For instance, the California Corporations Code enables the non-petitioning shareholders to avoid dissolution by purchasing the petitioner's equity at fair value.<sup>149</sup> Section 12.56 could be clearer; however, when considering its entire statutory structure, the buy-out remedy is quite limited. Its availability rests entirely in the hands of the party seeking relief.

With the amendments to the buy-out remedy, the General Assembly placed great weight on shareholder autonomy. That legislative judgment further suggests that director and custodial appointments under subsections (4),

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146. 805 ILL. COMP. STAT. 5/12.56(f) (2017).

147. See *Solon v. Midwest Med. Records Ass'n*, 925 N.E.2d 1113, 1117-18 (Ill. 2010) (stating that courts may consider consequences from construing a statute and in so doing may presume the General Assembly did not intend “absurd, inconvenient, or unjust consequences”).

148. See, e.g., MONT. CODE ANN. § 35-1-939 (2015) (allowing judge to award relief other than dissolution on any grounds “it considers appropriate,” with such relief to include the purchase of any shareholder's equity at fair value); *Balvik v. Sylvester*, 411 N.W.2d 383, 389 (N.D. 1987) (holding trial court abused its discretion in ordering dissolution; instructing court to require corporation or other shareholders to purchase minority interest at fair value).

149. CAL. CORP. CODE § 2000 (Deering 2017). Other states have similar procedures. See, e.g., N.H. REV. STAT. ANN. § 293-A:14.34(a) (2017); 7 R.I. GEN. LAWS § 7-1.2-1315 (2017).



(6), and (7) ought to be used sparingly in an equally-split firm; as such, an appointment is inconsistent with the shareholders' ability to retain full veto authority over the firm's management. So despite the range of potential remedies, none is a perfect fit for a deadlock claim—at least when the petitioning shareholder does not ask for the other shareholders to buy her out. The careful construction of the buy-out remedy forces a more in-depth analysis of dissolution as a default means to resolve deadlock.

#### IV. DECONSTRUCTING THE MODEL: DISSOLUTION AS A DRASTIC REMEDY

Subsection (12), the cautionary provision that allows a court to order dissolution only if no other remedy is sufficient,<sup>150</sup> finds roots in the common law. The general rule states that “[c]orporate dissolution is a drastic remedy that must not be lightly invoked.”<sup>151</sup> Viewing this black-letter principle in a vacuum, it is easy to discount dissolution as a viable equitable remedy in a section 12.56 suit. However, the drastic-remedy principle has devolved from three separate and independent sources, none of which is compelling enough to discount the viability of dissolution as a presumptively available remedy in the deadlocked corporation.

##### A. *The Common Law of Dissolution*

The first source comes from the interplay of related common-law principles. Long before the BCA was enacted, the Supreme Court of Illinois announced in *Wheeler v. Pullman Iron & Steel Co.* that “[i]n the absence of statutory authority, courts of chancery had no jurisdiction to decree a dissolution of a corporation by declaring a forfeiture of its franchise, either at the suit of an individual or of the state.”<sup>152</sup> Because courts construe statutes in derogation of the common law narrowly,<sup>153</sup> legislation authorizing a chancery court to dissolve and liquidate a business led courts to view dissolution with skepticism. The *Pullman* rule stems from the “concession theory” of corporate law and has no relevance today.<sup>154</sup> On this score, one commentator

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150. 805 ILL. COMP. STAT. 5/12.56(b)(12) (2017).

151. *Gidwitz v. Lanzit Corrugated Box Co.*, 170 N.E.2d 131, 138 (Ill. 1960); *see also Cent. Standard Life Ins. Co. v. Davis*, 141 N.E.2d 45, 51 (Ill. 1957).

152. *Wheeler v. Pullman Iron & Steel Co.*, 32 N.E. 420, 421 (Ill. 1892). This rule was by no means uniform at the time. The same year that the Supreme Court of Illinois decided *Wheeler*, the Michigan Supreme Court held in *Miner v. Belle Isle Ice Co.* that a court of equity could wind up a solvent corporation when it “utterly failed of its purpose, not because of matters beyond its control, but because of fraudulent mismanagement and misappropriation of its funds.” *Miner v. Belle Isle Ice Co.*, 53 N.W. 218, 224 (Mich. 1892).

153. *Summers v. Summers*, 239 N.E.2d 795, 798 (Ill. 1968).

154. *See* David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201, 205-12 (1990) (discussing public law view of corporations prevalent in 19th century).

has noted that “corporate statutes are not some legislative hoop through which one must jump in order to be endowed by the legislature with the privilege of doing business in the corporate form; rather they are an attempt to provide a format in which business can prosper, pay taxes, and employ voters.”<sup>155</sup> The corporate form has evolved and matured to the point where the observance of formalities is less important than it used to be.<sup>156</sup>

### B. Remedial Imbalance and Proportionality

The drastic-remedy principle further developed when courts lacked the authority to award any other remedies for petitioning shareholders *except* dissolution.<sup>157</sup> Courts addressed all shareholder claims in conjunction with the dissolution remedy—precisely because no other remedy was available.<sup>158</sup> The current version of section 12.56, last amended in 2005, includes eleven other equitable remedies, some of which amount to a wholesale judicial re-ordering of management and ownership.<sup>159</sup> Even those remedies do nothing to limit a judge’s discretion in shareholder disputes. If a court is so inclined, it can implement any other legal or equitable remedy sufficient to resolve the matters in dispute—whether or not it is listed under section 12.56.<sup>160</sup>

The current availability of multiple remedies to remediate shareholder oppression, director deadlock, and corporate waste, cuts both ways when examining whether dissolution is truly “drastic.” For starters, dissolution is plainly inappropriate in some cases. Consider a classic fact matrix involving a minority shareholder who pleads oppression. The majority, seeking to freeze-out a minority partner, authorizes excessive officer salaries and declines to pay dividends to the shareholders.<sup>161</sup> Subsection (9) enables a court, when faced with an oppression suit under these facts, to award payment of

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155. See Murdock, *supra* note 74, at 441.

156. See 805 ILL. COMP. STAT. 180/10-10(c) (2017) (stating that in Illinois limited liability company, the failure to “observe the usual company formalities or requirements relating to the exercise of its company powers or management of its business is not a ground for imposing personal liability on the members of managers for liabilities of the company”).

157. ILL. REV. STAT. 1955, chap. 32, par. 157.86(a). The Illinois Business Corporation Act of 1983, which went into effect July 1, 1984, replaced the Business Corporation Act of 1933. As one commentator describes, the 1983 Act replaced as much as eighty percent of the 1933 Act. James M. Van Vliet, Jr., *The New Illinois Business Corporation Act Needs More Work*, 61 CHI.-KENT L. REV. 1, 3 (1985).

158. See *Cent. Standard Life Ins. Co. v. Davis*, 141 N.E.2d 45, 50-51 (Ill. 1957) (analyzing oppression facts in light of request for corporate liquidation).

159. See *supra* text accompanying notes 107-30.

160. 805 ILL. COMP. STAT. 5/12.56(c) (2017).

161. See, e.g., *Rexford Rand Corp. v. Ancel*, 58 F.3d 1215, 1227 n.3 (7th Cir. 1995) (discussing concept of minority shareholder “freeze-out”); *Miller v. Magline, Inc.*, 256 N.W.2d 761 (Mich. Ct. App. 1977).

dividends to the complaining shareholder.<sup>162</sup> It may also require the corporation to set aside any corporate act under subsection (1) so that it can pay those dividends without jeopardizing cash flow.<sup>163</sup> And of course, many aggrieved minority shareholders would want to sell their equity when confronted with oppressive conditions.

Under these facts, a request for dissolution would be wholly disproportionate to the significant, though individualized, harm the minority shareholder incurred. Neither the shareholders nor the court could justify disrupting an entire going-concern enterprise when a lesser remedy specific to a particular shareholder is enough to cure the complained-of conduct, even if that conduct borders on malfeasance. In this sense, courts may properly consider dissolution to be a “drastic” remedy. But in a practical sense, the shareholders cannot seek the remedy regardless because it would be wholly disproportionate to the claimed injury.<sup>164</sup>

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162. 805 ILL. COMP. STAT. 5/12.56(b)(9) (2017).

163. 805 ILL. COMP. STAT. 5/12.56(b)(1) (2017).

164. *See* *Kalabogias v. Georgou*, 627 N.E.2d 51, 54 (Ill. App. Ct. 1993) (in shareholder oppression case, noting both sides sought share-purchase remedy in lieu of dissolution); *Hockenberger v. Curry*, 215 N.W.2d 627, 628 (Neb. 1974) (noting “drastic” remedy of liquidation “must be invoked with extreme caution,” but so noting in context of minority shareholder oppression). Claims of corporate waste also suggest remedies short of dissolution. Minority shareholders often bring litigation when those in control of the corporation misapply firm assets or divert them for personal use, such as to pay for life insurance, legal fees, or to fund an affiliate entity. *See, e.g., Williams v. Fugett*, No. 3-13-0834, 2014 WL 4439631, at \*5-6 (Ill. App. Ct. Sept. 9, 2014). The specter of corporate waste may lead a court to order an accounting of any disputed transfers under subsection (5) and even the appointment of a custodian to manage the corporation’s affairs under subsection (6). Dissolution under this fact-pattern again would lack proportionality to the merits, since lesser remedies would redress the particularized harm pled by a petitioning shareholder.

Put differently, the remedial scheme embodied within section 12.56 contains an implicit proportionality requirement. The statute is flexible enough to address myriad shareholder disputes, ranging from ones where harm is discrete and individualized to those in which it is crippling and pervasive. To be sure, dissolution is indeed drastic, but only when viewed against the particular facts and the availability of other remedies to accomplish a complaining shareholder's objective. Cases of director deadlock merit special treatment, though. A court first must find injurious management paralysis or a complete defeat of the corporate purpose before even considering what remedy to impose.<sup>165</sup> The universe of sufficient remedies, therefore, narrows significantly. Targeted, surgical action is simply not sufficient to cure deadlock.<sup>166</sup>

### C. *The Specter of Minority Opportunism*

Corporations span a broad structural continuum. On the one hand, they can resemble partnerships, where a small group of owners also retains active management rights. Conversely, many corporations are decentralized and even look like publicly-traded firms. In this latter class, minority shareholders may play no active role in the firm's management. Liberal dissolution rights for this archetypal corporation would vest too much control in passive entity participants and give rise to the potential for opportunism by a minority shareholder to wrest away entity control from the majority.<sup>167</sup>

The drastic-remedy principle counterbalances the potential for opportunism that liberal dissolution rights may create when placed in the hands of minority shareholders. In many respects, the concern for opportunism is a reflection of the remedial imbalance that often attended shareholder disputes. But as the very text of section 12.56 illustrates, that imbalance no longer exists. And in cases involving corporations that, at the margins, simulate equal partnerships, concerns about minority opportunism vanish. In these corporations, the retention of management veto authority militates against the risk of pure opportunistic behavior.

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165. See *supra* text accompanying notes 74-100; See also *Callier v. Callier*, 378 N.E.2d 405, 408 (Ill. App. Ct. 1978) (stating deadlock must be of "such serious proportions as to defeat the end for which the corporation is organized").

166. See *Israels*, *supra* note 13, at 793 ("[I]t seems clear to the writer that a simple and flexible remedy for deadlock or stalemate must be provided, and that the untouchability of the sacred cow must not be permitted to impede its exercise.").

167. See Charles R. O'Kelley, Jr., *Filling Gaps in the Close Corporation Contract: A Transaction Cost Analysis*, 87 Nw. U. L. REV. 216, 239-41 (1992) (discussing reasons why investors choose particular types of entities).

## V. EXTERNAL DISSOLUTION CONSIDERATIONS

Remedies for deadlock are highly dependent on decisions shareholders make when they form their enterprise. Shareholders can, and sometimes do, deal with deadlock in their planning documents.<sup>168</sup> Deadlock avoidance mechanisms may be found in corporate bylaws,<sup>169</sup> but they also are appropriate to include in shareholder agreements.<sup>170</sup> Although new business partners may not be inclined to plan for an acrimonious separation, advance contract planning helps establish their expectations and reduces uncertainty associated with litigating deadlock claims.

Planning, though, has its inherent limitations. Nobel laureate Herbert A. Simon espoused a theory of “bounded rationality,” in which he stated that individuals’ capacity to undertake a particular course of action is bounded by “cognitive limits.”<sup>171</sup> That is, Simon believed individuals have a limited ability to assimilate all available information necessary to make a decision.<sup>172</sup> They, therefore, resort to something acceptable, instead of what is optimal.<sup>173</sup> The behavioral model of bounded rationality applies with great force to business owners’ initial planning, such as the relative distaste for dickering over corporate bylaws and shareholder agreements.<sup>174</sup> Given the consequences and the investments shareholders make in their own enterprise, one would think just the opposite.<sup>175</sup>

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168. See Claudia M. Landeo & Kathryn E. Spier, *Irreconcilable Differences: Judicial Resolution of Business Deadlock*, 81 U. CHI. L. REV. 203, 204 (2014).

169. A corporation’s bylaws constitute a contract defining the rights and duties of the corporation and its shareholders with respect to each other. *Teschner v. Chi. Title & Tr. Co.*, 322 N.E.2d 54, 57 (Ill. 1974).

170. The BCA enables corporations to use shareholder agreements for a wide range of purposes. Section 7.71 provides that a shareholder agreement is not invalid on the basis that it “so relates to the conduct of the affairs of the corporation as to interfere with the discretion of the board of directors.” 805 ILL. COMP. STAT. 5/7.71(c) (2017).

171. Herbert A. Simon, *A Behavioral Model of Rational Choice*, in *MODELS OF MAN, SOCIAL AND RATIONAL: MATHEMATICAL ESSAYS ON RATIONAL HUMAN BEHAVIOR IN A SOCIAL SETTING* 99 (1957).

172. *Id.*

173. *Id.*

174. See Noam Wassermann & Thomas Hellmann, *The Very First Mistake Most Startup Founders Make*, HARV. BUS. REV. (Feb. 23, 2016), <https://hbr.org/2016/02/the-very-first-mistake-most-startup-founders-make> [<https://perma.cc/8WMC-EZ8W>] (stating that founders prioritize operational decisions above “how to structure their own founding teams”).

175. See Brent Beshore, *Why Small Businesses Are Feeling an Economic Crunch*, FORBES (Oct. 11, 2015, 6:00 AM), <http://www.forbes.com/sites/brentbeshore/2015/10/11/the-small-business-crunch/#74125b7c5dc7> [<https://perma.cc/JU3U-SB4V>] (noting many “business owners have 80% or more of their personal assets tied up in their businesses”).

### A. *Deadlock Avoidance Mechanisms*

Co-venturers, of course, remain free to choose among a variety of contractual clauses that avoid deadlock.<sup>176</sup> Generally, these deadlock avoidance mechanisms take two forms: (1) tie-breakers; and (2) buy-sell provisions.

Tie-breaker clauses are easy to draft and conceptually simple to understand. But, they have limitations. Typically, a tie-breaker provision will call upon a specific person to break management deadlock. The tie-breaker is sometimes the board chairperson or a third-party. Locating an independent tie-breaker may be an arduous task, for few likely are willing to undertake this endeavor.<sup>177</sup> A tie-breaker appointee also may worry about the perception that he is colluding with an existing shareholder faction. And an outsider who is not familiar with the day-to-day business of the corporation may fear liability from making a key business judgment—or may not understand enough to make that judgment in the first place.

Other tie-breaking clauses may call for the directors to take alternating turns casting the decisive vote. Internal tie-breaking mechanisms, though, are inconsistent with the purpose of an equally-divided firm. Owners expect to have an equal say in management, which corresponds to an unfettered veto right—regardless of whether that right ultimately proves to be judicious. Just as problematically, alternating tie-breaker systems between directors (or among director groups) can encourage them to game the system and feign deadlock over secondary issues in the hopes of gaining a deciding vote on more critical ones.

Other deadlock avoidance mechanisms resemble buy-sell arrangements. The Arizona Court of Appeals in *Gries v. Plaza Del Rio Mgmt. Corp.*<sup>178</sup> discussed one common mechanism, a “shotgun” provision, and said that it:

allows one party to set the purchasing price of other party’s shares, and the other party the option of buying or selling the shares at that price. If the first party sets the share price below its fair value, that party risks the other party buying the shares too cheaply. If the first party sets the price above fair value, that party risks the other party selling the shares at an inflated price.<sup>179</sup>

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176. See Kerry M. Lavelle, *Drafting Shareholder Agreements for the Closely-Held Business*, 4 DEPAUL BUS. L.J. 109, 127 (1991).

177. See *supra* text accompanying notes 128-29.

178. *Gries v. Plaza Del Rio Mgmt. Corp.*, 335 P.3d 530 (Ariz. Ct. App. 2014).

179. *Id.* at 535-36.

In *Gries*, the court affirmed a decision to halt the dissolution proceedings filed by one shareholder, relying on the built-in fairness of the shotgun provision to yield an equitable outcome.<sup>180</sup>

Shareholders could also agree in their planning documents that if any of them files an action for dissolution, the corporation will commission a fair-value opinion, at which point the petitioning shareholder must sell according to the price returned. As *Gries* illustrates, courts welcome this sort of *ex ante* planning—particularly given that it seems to promote a logical, ordered departure mechanism for one who no longer wishes to remain in the closely-held firm.<sup>181</sup> However phrased, a buy-sell mechanism has the benefit of fostering continuity, avoiding litigation, and incentivizing director-shareholders to act in good faith.

The availability of contractual mechanisms designed to avoid deadlock raises an intuitive question related to the contract at issue in *Gries*: Can shareholders waive the right to seek judicial dissolution? Not surprisingly, the question rarely arises in litigation. One case that strictly enforced the parties' waiver clause is *R&R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, in which members of a limited liability company agreed to waive any judicial dissolution rights they had.<sup>182</sup> The Delaware Court of Chancery held that such a provision indeed barred a dissolution proceeding, since it did not contravene the Delaware Limited Liability Company Act and was not against public policy.<sup>183</sup> The court further noted that the members had "legitimate business reasons" for wanting to waive judicial dissolution rights in advance, not the least of which was the risk that such an action could constitute a "non-curable event of default" in a credit facility.<sup>184</sup>

On the other hand, the Appellate Court of Connecticut held in *Chance v. Norwalk Fast Oil, Inc.* that a shareholder agreement's tie-breaking provision did not provide a jurisdictional defense to a dissolution suit.<sup>185</sup> The parties' stalemate clause required them to submit matters to an unidentified

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180. *Id.* at 534-36.

181. *See* *Kirksey v. Grohmann*, 754 N.W.2d 825, 831 (S.D. 2008) (noting that in dissolution of LLC, "[n]o procedure exists in the company's documentation to break a tie vote [among members] and protect the company in the event of changed conditions").

182. *R&R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, No. 3803-CC, 2008 WL 3846318, at \*3 (Del. Ch. Aug. 19, 2008).

183. *Id.* at \*6-7.

184. *Id.* at \*7. Subsequent decisions have disagreed with *R&R Capital*, noting that 2013 legislative amendments may have undercut the case's reasoning. *In re Carlisle Etcetera, LLC*, 114 A.3d 592, 605 (Del. Ch. 2015). That said, courts should enforce any sort of waiver mechanism upon which members of an LLC agree. LLCs are an "unincorporate" form, which give primacy to founders' contractual rights (as long as those rights do not prejudice creditors). *See generally* Larry E. Ribstein, *THE RISE OF THE UNINCORPORATION* (2010).

185. *Chance v. Norwalk Fast Oil, Inc.*, 739 A.2d 1275, 1279-80 (Conn. App. Ct. 1999).

third-person, on whom the warring directors presumably had to agree to appoint as the tie-breaker.<sup>186</sup> Given the parties' years of animosity and failure to speak or hold meetings, the court found that the trial court "properly stepped in to break the stalemate by dissolving the corporation."<sup>187</sup> In so holding, the court rejected the argument that the petitioning shareholder waived the right to seek judicial dissolution, instead stating that the defendants "have pointed to no language in the shareholder agreement that provides unequivocally that any stockholder agreed to waive his right to seek a dissolution . . . ."<sup>188</sup> Therefore, it is unclear whether the Appellate Court of Connecticut would have enforced a complete waiver provision similar to that at issue in *R&R Capital*.

Regardless of the tension apparent from these cases, if contracting parties decide on a deadlock avoidance mechanism in their planning documents, they, at least implicitly, have decided to avoid seeking court intervention based on deadlock.<sup>189</sup> Even if there is no explicit language of that seemingly required by the court in *Chance*, a contract dealing with conflict avoidance is a specific *ex ante* ordering of rights that should preclude courts from intervening even if a statute otherwise would permit them to do so.<sup>190</sup> To this end, the *Gries* model of staying a dissolution proceeding to let the agreed-upon buy-out proceed honors careful advance planning the shareholders undertook.

Contract-based judicial decision-making also leads to a more efficient result for the shareholders since courts need not examine the corporation's internal affairs to ascertain fault. Indeed, in deadlock claims, this rarely is a core judicial function anyway. Deadlock is not a claim focused on wrongdoing;<sup>191</sup> rather, it is procedural matter impacting corporate governance. Parties can plan for management deadlock without impinging on public-policy concerns.<sup>192</sup> Particularly given the General Assembly's recognition of shareholder autonomy and primacy concerning the share-purchase remedy,<sup>193</sup>

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186. *Id.* at 1279.

187. *Id.* at 1280.

188. *Id.*

189. Robert B. Thompson, *Corporate Dissolution and Shareholders' Reasonable Expectations*, 66 WASH. U. L. Q. 193, 227 (1988) (advocating against a rule that bars dissolution if there is a generic buy-sell agreement, unless the shareholders knowingly agreed specifically to waive the right to seek dissolution).

190. *See* *Midwest Television, Inc. v. Oloffson*, 699 N.E.2d 230, 236 (Ill. App. Ct. 1998) (stating that waiver is the "voluntary relinquishment of a known right").

191. *See In re Goodman v. Lovett*, 607 N.Y.S.2d 52, 53 (N.Y. App. Div. 1994).

192. *See* 15 PA. CONS. STAT. § 1981(a)(3) (2016) (providing that in case of director deadlock, courts may not appoint receiver or grant similar relief if shareholders "by agreement or otherwise have provided for the appointment of a provisional director or other means for the resolution of a deadlock . . . .").

193. *See supra* text accompanying notes 137-49.



courts should embrace contractual mechanisms that facilitate private deadlock solutions. A court's function, when faced with an advance-planning clause, is to ensure the shareholders adhere to it rather than supplant it with a default statutory remedy that is waivable and textually disfavored.<sup>194</sup>

### B. *The Limits of Ex Ante Planning*

Though courts should enforce deadlock avoidance mechanisms liberally, those contractual clauses are uncommon. Consider the prototypical business that is most suited for deadlock: the closely-held family firm, in which management responsibility passes down from one generation to the next. The *2014 PwC Family Business Survey* revealed that fewer than thirty percent of these family businesses have any conflict resolution mechanism.<sup>195</sup> This statistic illustrates a truism known to experienced corporate counsel: the businesses that most need contractual mechanisms to resolve conflict are the ones least likely to have them.

Empirical data even suggest that companies with equally-divided ownership (and therefore an equally-divided board) are structurally flawed from the outset. These flaws render them less likely to succeed than firms with an unequal division of equity among founders. Research by Professors Noam Wassermann and Thomas Hellmann confirms that equally-split companies raise less outside funding from venture capitalists and have lower median valuations.<sup>196</sup> To this end, Wassermann and Hellman have concluded that founders who decide on equal-share splits do so very quickly and that this arrangement is “a symptom of bigger issues with the company.”<sup>197</sup> Those bigger issues illustrate that equal splitters are unable or unwilling to have candid, thoughtful discussions about each other's relative contributions to the firm before deciding on how much of the business they should own.<sup>198</sup>

As the early empirical research conducted by Wassermann and Hellmann describes, it is nearly impossible for owners of a startup to understand and anticipate each other's value over the enterprise's lifespan.<sup>199</sup> They postulate:

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194. See *supra* text accompanying notes 151-52.

195. See *2014 Family Business Survey – Explore the Data*, PWC GLOBAL, <http://www.pwc.com/gx/en/services/family-business/family-business-survey/explore-the-data.html> (last visited Apr. 4, 2016).

196. Louise Lee, *Beware Startups Where the Founders Have Equal Stakes*, WALL ST. J., May 2, 2016, at R3 (citing research for forthcoming publication).

197. See Wassermann & Hellmann, *supra* note 174.

198. *Id.*

199. See Thomas Hellmann and Noam Wassermann, *The First Deal: The Division of Founder Equity in New Ventures* 5 (Harvard Bus. Sch., Working Paper No. 14-085, 2012), [http://www.hbs.edu/faculty/Publication%20Files/14-085\\_2bd67a49-bd41-4396-a69d-73a7f40829b8.pdf](http://www.hbs.edu/faculty/Publication%20Files/14-085_2bd67a49-bd41-4396-a69d-73a7f40829b8.pdf) [<https://perma.cc/8WMC-EZ8W>].

Founder negotiations occur at a time when there is extreme uncertainty; in the early life of a startup, technology, products and markets are often ill-defined. As a result, founders have a highly incomplete understanding of the skills and tasks that the venture will need. In addition, founders don't know each other's true skills and commitment, nor their compatibility as a team. As a consequence, there is considerable uncertainty, and ample room for disagreement about what the true differences among founders will turn out to be.<sup>200</sup>

The foundational flaw in the equally-divided firm, then, is that the even split stems from a hastily-reached decision meant to avoid conflict and to eschew difficult decision-making about the firm and the founders' management rights. This decisional matrix increases the likelihood that the owners will be unable to plan for dissension or, worse, remediate dissension when it arises.<sup>201</sup>

Professor Robert B. Thompson has a similar theory about why equal firms may be structurally deficient, though he focuses more on *ex ante* perceptions of trust among founders. In Professor Thompson's view, "Investors often fail to anticipate the failure of their enterprise, or they demonstrate an overly optimistic trust in those with whom they are undertaking the venture."<sup>202</sup> His observation reinforces Simon's theory of bounded rationality. That is, owners may know their new business lacks formality or appropriate planning, but they nevertheless make the informed decision that it is simply good enough under the circumstances.<sup>203</sup> This initial trust among stakeholders—at its zenith when a new business starts—can obscure the need to plan for touchy subjects, not the least of which is the possibility of deadlock.<sup>204</sup>

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200. *Id.*

201. See William J. Carney, *The Theory of the Firm: Investor Coordination Costs, Control Premiums and Capital Structure*, 65 WASH U. L. Q. 1, 59-60 (1987) (discussing Simon's theory of bounded rationality and incidence of investor conflicts in the closely-held firm).

202. See Thompson, *supra* note 189, at 199.

203. See Carney, *supra* note 201, at 60 (stating that the "initial glow of enthusiasm for a new business may prevent investors from reflecting fully upon" planning problems).

204. See Katia Savchuk, *Inside the Nasty Corporate Divorce Between Ex-Lovers Who Built a Company Worth Nearly \$1 Billion*, FORBES (May 25, 2016, 8:00 AM), <http://www.forbes.com/sites/katiasavchuk/2016/05/25/liz-eltig-transperfect-engaged-co-founders-phil-shawe-corporate-divorce/#37bd98752c2e> [<https://perma.cc/BH68-H7E5>] (describing how founders of TransPerfect split business 50/50 and "never drew up a buy-sell agreement or cemented their roles on paper").

When litigation ensues, it often becomes apparent that the founders never informed themselves of their rights, duties, and obligations to the enterprise.<sup>205</sup>

Coupled with unbridled optimism, the shareholders may also forego sound legal advice during the firm's planning stage.<sup>206</sup> Indeed, it is quite common for new business owners to choose corporate counsel to draft a standard set of corporate documents that lack customization to the founders' particular business. Often times, counsel is not even familiar with her client's proposed business model or simply will follow instructions to stay out of the way.<sup>207</sup> And neither the lawyer nor the individual owners may fully appreciate whom the lawyer actually is representing—a particular owner or the firm itself.<sup>208</sup> Shareholders tend to view legal formalities as a waste of time and resources, preferring instead to focus on setting an infrastructure—vendors, customers, and operating systems—that will support their new firm.<sup>209</sup> Their failure to procure sound legal advice supports the conclusions of Professors Wassermann, Hellmann, and Thompson that behavioral constraints significantly limit shareholders' capacity to plan.<sup>210</sup> These constraints gird deadlock disputes and help suggest to courts which remedial options are most appropriate.

### C. *Revisiting Section 12.56: Shareholders' Reasonable Expectations*

If owners' limited capacity to plan for management deadlock informs a court's willingness to consider certain remedial options, then so too should the concept of shareholders' reasonable expectations. This premise is firmly embedded within section 12.56:

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205. See *Inca Materials, Inc. v. Indigo Constr. Servs.*, No. 1-14-1345, 2015 WL 6955213, at \*15 (Ill. App. Ct. Nov. 10, 2015) (“The case . . . involved a group of people who entered into a business arrangement without discussing the details, without considering their ensuing duties, without making a sufficient effort to keep themselves apprised of how the business was operating, and without asking questions when questions needed to be asked.”).

206. See J.A.C. Hetherington, *Special Characteristics, Problems, and Needs of the Close Corporation*, 1969 U. ILL. L. F. 1, 17-18 (1969) (discussing that minority shareholder stock purchases are “likely to be arranged without either party consulting a lawyer. The result is the assumption of a minority stock position without, or with only limited, appreciation of the risks involved.”).

207. See Carney, *supra* note 201, at 60 (noting corporate lawyers provide incomplete organizational advice for fear of “queering the deal”).

208. See Christopher P. Clasby, *The Ethics of Representing Corporations*, ILL. B. J., June 2016, at 40, 41 (noting that identifying the proper client “can be confusing because the lawyer acts at the direction of the corporation’s duly authorized constituents. As such, lawyers and the authorized constituents may forget about the actual client and where their loyalties lie.”).

209. See Wassermann & Hellmann, *supra* note 174.

210. See Thompson, *supra* note 189, at 224.

In determining the appropriate relief to order pursuant to this Section, the court may take into consideration the reasonable expectations of the corporation's shareholders as they existed at the time the corporation was formed and developed during the course of the shareholders' relationship with the corporation and with each other.<sup>211</sup>

The reasonable-expectations provision is a feature of both the BCA and other states' corporations laws.<sup>212</sup> Aside from stating simply that a court *may* consider shareholder expectations when ordering relief, the BCA offers no guidance as to what the term "reasonable expectations" actually means or how to apply it to remedial choice.<sup>213</sup> But in the closely-held firm, the expectations that shareholders have—either objectively viewed or subjectively expressed—no doubt factor into the overall remedial mix.

A shareholder's reasonable expectations in a closely-held firm generally are imbued with certain fundamental features. Those features are notably different than what a shareholder tends to expect out of a passive investment in a publicly-traded organization.<sup>214</sup> In particular, shareholders expect symmetry, rather than separation, between ownership and management.<sup>215</sup> They further expect continuing employment, a reasonable salary, dividends, and a restriction on their partners' ability to transfer ownership in the firm to outsiders.<sup>216</sup>

Shareholder expectations concerning management in an equally-split corporation derive largely from the decisions they make—or perhaps more accurately, avoid making—when structuring the firm. By agreeing to equal economic *and* management rights, a court reasonably can determine that the shareholders expect to have full veto authority over corporate action. Or, stated differently, a court can conclude that the equal shareholders expect to agree on all decisions that impact the firm's strategic direction. This conclusion comports with the objective theory of contract, in which courts determine intent by examining the language of the governing agreement.<sup>217</sup> To be sure, the concepts of intent and shareholder expectations are synonymous.

211. 805 ILL. COMP. STAT. 5/12.56(d) (2017).

212. *See, e.g.,* Stefano v. Coppock, 705 P.2d 443 (Alaska 1985); Fox v. 7L Bar Ranch Co., 645 P.2d 929 (Mont. 1982); Meiselman v. Meiselman, 307 S.E.2d 551 (N.C. 1983). Some states, like Illinois, set forth the "reasonable expectations" standard in their corporations statute. *See* N.D. CENT. CODE § 10-19.1-115(5) (2017).

213. 805 ILL. COMP. STAT. 5/12.56(d) (2017).

214. *See* Israels, *supra* note 13, at 778-79 (discussing commonly held expectations of shareholders in closely-held firm).

215. *Meiselman*, 307 S.E.2d at 558 (citing F. Hodge O'Neal, *Close Corporations: Existing Legislation and Recommended Reform*, 33 BUS. LAW 873, 885 (1978)).

216. *See* Thompson, *supra* note 189, at 194, 196.

217. *Empro Mfg. Co. v. Ball-Co Mfg. Inc.*, 870 F.2d 423, 425 (7th Cir. 1989).

An *ex ante* planning model that enables an equal owner's full veto power is the best objective reflection of the owners' reasonable expectations concerning firm management.

In terms of remediating deadlock, the concept of reasonable expectations becomes murky. Those expectations may develop long after the entity's formation and may be little more than a *post hoc* reflection of the external constraints described by Professors Wassermann, Hellmann, and Thompson. That is to say, if the owners' planning decisions and organizational documents facilitate deadlock, a petitioning shareholder may expect that a court will step in and order the business dissolved. But she may never gain that expectation until deadlock is apparent. To that end, the concept of reasonable expectations in a deadlock suit simply may start and end with the terms of the parties' organizational documents. Courts may interpret the parties' failure to plan for deadlock in advance as a tacit expression that dissolution is within their reasonable expectations, particularly since that remedy is available by default under section 12.56.<sup>218</sup>

## VI. RECONSTRUCTING THE MODEL: DISSOLUTION AS A DEFAULT REMEDY

Because behavioral constraints limit advance planning in an equally-split firm, it is understandable that many corporate contracts will not address management deadlock. Even if this failure to plan amounts to a tacit concession that courts should remediate deadlock, a more fundamental question persists: Why would a shareholder prefer dissolution as a remedy for director deadlock instead of simply cashing out of the firm? The answer should inform courts' view of dissolution as a default remedy for deadlock cases.

### A. *Dissolution as a Motivating Force*

The principal motivation for why a shareholder would seek an order of dissolution in lieu of a buy-out remedy stems from the shareholder's need to avoid forward-looking conduct restrictions. Under Illinois law, those restrictions arise from two related sources: contractual restrictive covenants and default fiduciary duty rules.

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218. See *In re Collins-Doan Co.*, 70 A.2d 159, 166 (N.J. 1949) (construing statutory dissolution procedure for corporations and noting that in case of deadlocked directors "[c]ertainly, dissolution was within the contemplation of the shareholders here if differences arose which could not be composed."). *But cf.* Stephen M. Bainbridge, CORPORATION LAW AND ECONOMICS 830 (2002) ("[P]arties who want liberal dissolution rights may bargain for them . . . before investing.").

### 1. Shareholder-Based Restrictive Covenants

Shareholder agreements often contain covenants not to compete.<sup>219</sup> Triggering events for a shareholder-based covenant can include retirement, termination of employment, or the sale of shares (whether to the firm, the remaining shareholders, or an outside party). Courts in Illinois enforce these transactional-based covenants with regularity and without the heightened level of scrutiny associated with employment-based restraints.<sup>220</sup>

The most compelling discussion for why courts enforce covenants in shareholder agreements comes from Judge Easterbrook's opinion in *Hess Newmark Owens Wolf, Inc. v. Owens*.<sup>221</sup> The court there noted the benefit that restrictive covenants provided to the ownership group:

But for the restrictive covenant, each of the three [shareholders] would face not only the business risks endemic to the venture but also the risk that one or more of the other principals would bolt and leave the others with neither a viable business at [their firm] nor another business to go back to . . . . Keeping a personal-services business together can be difficult without the sort of trust and confidence engendered by promises to stick with the firm rather than strike off on one's own at the first opportunity.<sup>222</sup>

As Judge Easterbrook's opinion illustrates, the rationale for endorsing, rather than striking, restrictive covenants in shareholder agreements is that "those who have an equity stake in a venture need to secure the loyalty of those similarly situated to themselves."<sup>223</sup> Should the shareholders of a

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219. See, e.g., *Hasley v. Harrell*, 971 So.2d 149, 151 (Fla. Dist. Ct. App. 2007) (action to enforce covenants not to compete in employee and stockholder agreements); *Wainwright's Travel Serv., Inc. v. Schmolck*, 500 A. 2d 476, 477-79 (Pa. Super. Ct. 1985) (same; discussing reasonableness of covenant tied to stock ownership).

220. See *Cent. Water Works Supply, Inc. v. Fisher*, 608 N.E.2d 618, 622-23 (Ill. App. Ct. 1993) (concluding restrictive covenant in shareholder agreement was more akin to covenant ancillary to sale of business); *Eichmann v. Nat'l Hosp. & Health Care Servs.*, 719 N.E.2d 1141, 1145-46 (Ill. App. Ct. 1999) (describing different standards for enforcement of employment- and transactional-based restrictive covenants).

221. *Hess Newmark Owens Wolf, Inc. v. Owens*, 415 F.3d 630 (7th Cir. 2005).

222. *Id.* at 631.

223. See Kenneth J. Vanko, *Non-Compete In Shareholder Agreement Found Unenforceable* (*Lampman v. DeWolff, Boberg & Assoc.*), LEGAL DEV. NON-COMPETITION AGREEMENTS (Mar. 27, 2009, 10:04 AM), <http://www.non-competes.com/2009/03/non-competes-in-shareholder-agreement.html> [<https://perma.cc/E7TM-D9MD>].

closely-held firm agree in advance to restrictive covenants, a shareholder may conclude the risk of leaving to compete simply is too great. The potential for staring down a coercive injunction, as well as steep litigation costs, incents the shareholder to stay. And although courts sometimes find shareholder-based restrictive covenants unenforceable,<sup>224</sup> the prevailing test in Illinois favors enforcement of freely-negotiated documents between sophisticated business people with equal bargaining power.

## 2. Common-Law Fiduciary Duties

Shareholders of an equally-divided firm may be constrained even if their planning documents omit a restrictive covenant altogether. Illinois law is less than clear on what level of fiduciary duties shareholders in a closely-held corporation owe each other and the firm. But in a company where the shareholders retain *equal* shares and an *equal* say in management, the law seems to favor expansive fiduciary obligations akin to those of true partners. The principal fiduciary-duty case that will inform a shareholder's decision to leave and compete is *Hagshenas v. Gaylord*.<sup>225</sup> Bruce Hagshenas, a fifty-percent shareholder and director of a small business, filed a dissolution action due to management deadlock.<sup>226</sup> Eventually, he resigned as both an officer and director, starting up a competing firm in the process.<sup>227</sup> Hagshenas then hired employees away and solicited his company's customers, all while the dissolution proceeding remained pending.<sup>228</sup>

The Appellate Court of Illinois relied on a prior Supreme Court of Illinois decision, *Illinois Rockford Corp. v. Kulp*,<sup>229</sup> in holding that Hagshenas had a continuing fiduciary duty to both the firm and its shareholders.<sup>230</sup> At their core, *Hagshenas* and *Kulp* found that shareholders in a closely-held corporation with equal voting power were similar to partners, a finding that undoubtedly is pragmatic and correct.<sup>231</sup> For its part, the court in *Hagshenas* also noted Bruce's great influence and continued control over the business as a fifty-percent owner.<sup>232</sup> This dictum caused subsequent courts to restrain

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224. See *Lampman v. DeWolff Boberg & Assocs.*, 319 Fed. App'x 293, 301-02 (4th Cir. 2009) (finding three-year restrictive covenant in shareholder agreement was unenforceable due to problem with definition of what constituted "Competition").

225. *Hagshenas v. Gaylord*, 557 N.E.2d 316 (Ill. App. Ct. 1990).

226. *Id.* at 317.

227. *Id.* at 319.

228. *Id.*

229. *Ill. Rockford Corp. v. Kulp*, 242 N.E.2d 228 (Ill. 1968).

230. *Hagshenas*, 557 N.E.2d at 323.

231. *Id.* at 322; *Kulp*, 244 N.E.2d at 233 (citing *Helms v. Duckworth*, 249 F.2d 482 (D.C. Cir. 1957) and *Sher v. Sandler*, 90 N.E.2d 536 (Mass. 1950)).

232. *Hagshenas*, 557 N.E.2d at 323.

*Hagshenas*' potential reach, qualifying to a large degree the extent of a shareholder's fiduciary obligations in a closely-held firm.<sup>233</sup> The confusion in Illinois law concerning shareholder-based fiduciary duties, though, applies mainly to *minority* shareholders. Because of *Hagshenas* and *Kulp*, a shareholder who owns fifty percent of the firm's stock likely retains a broad fiduciary duty not to compete, again equivalent to that of a partner, even if the company's planning documents lack an express restrictive covenant.<sup>234</sup>

The General Assembly, in delayed response to *Hagshenas*, enacted a procedural route for shareholders to terminate their fiduciary duties. Section 7.90 of the BCA allows a shareholder to resign and terminate her fiduciary duties to a corporation.<sup>235</sup> The shareholder must irrevocably waive her right to vote any of the firm's shares, to be elected a director or officer, and to control corporate actions.<sup>236</sup> The statutory waiver device, though, may be an imperfect solution for a shareholder in a deadlocked corporation. Even if the shareholder can walk away and terminate her fiduciary duties, she will still cede control of key assets to her business partner. A shareholder may perceive this concession as inequitable, since her expectations going into the venture were to have equal say in both economic and management rights for the firm.<sup>237</sup> Since deadlock is not a fault-based claim, this inequity suggests few shareholders will use section 7.90 as an extrajudicial remedy.

### B. *Shareholder Motivations and Election of Remedies*

Conduct restrictions, therefore, dictate remedial choice. Dissolution, if granted, will free the shackles that contracts or the common law may impose on a fifty-percent shareholder.<sup>238</sup> A buy-out remedy, on the other hand, only further increases the uncertainty that may await a petitioning shareholder in terms of what ventures she is able to exploit.

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233. See, e.g., *Dowell v. Bitner*, 652 N.E.2d 1372, 1379 (Ill. App. Ct. 1995) (finding minority shareholder who owned twenty-three percent of firm's equity did not owe fiduciary duty because he did not have the ability to control, hinder, or influence the corporation).

234. See *Apex Med. Research, AMR, Inc. v. Arif*, 145 F. Supp. 3d 814, 840 (N.D. Ill. 2015) (declining to find that fifty-percent shareholder owed fiduciary duty to corporation as a matter of law).

235. 805 ILL. COMP. STAT. 5/7.90 (2017).

236. *Id.*

237. See *supra* text accompanying notes 211-18.

238. Cf. *Dremco, Inc. v. S. Chapel Hill Gardens, Inc.* 654 N.E.2d 501, 507 (Ill. App. Ct. 1995) (dissolution ends fiduciary obligations of partnership except for winding up of affairs).



To this end, if a shareholder petitions a court for a buy-out of her shares under subsection (11), a court may condition a fair-value payment on compliance with restrictive covenants.<sup>239</sup> This condition may be the continuation of a pre-existing contractual arrangement or a judicial acknowledgment that the covenant is necessary to protect the sale of firm goodwill. Either way, the impact is the same. The mere potential for having to abide by a restriction (even if the parameters of that restriction are unknown) will inform a shareholder's decision whether to seek a buy-out in the first place. To be certain, a court hearing a deadlock case could strike any subsisting non-compete or *not* order it as a condition of share-purchase remedy.<sup>240</sup> But fair value is the standard for a share-purchase remedy under section 12.56.<sup>241</sup> And fair value normally includes a goodwill component, which a restrictive covenant in the theory protects.<sup>242</sup>

In the case of the profitable enterprise, fair value should exceed liquidation value because a going-concern enterprise should attract a third-party purchaser's interest at a level above what a pure sale of its component assets would net. Assuming a deadlock case yields a judgment of dissolution, the shareholders will only receive liquidation value less administrative expenses.<sup>243</sup> So when a shareholder elects a buy-out remedy and foregoes any request for dissolution, a court may be tempted to order some sort of a restrictive covenant on the selling shareholder to compensate the buyer for paying the higher price—that is, the price above pure liquidation value.

From the petitioning shareholder's perspective, the value of avoiding non-compete obligations (whether one exists or is judicially ordered as part of a share-purchase remedy) should exceed any difference between fair value and liquidation value for her equity. It is hard to see, though, how great of a difference there would be between fair value and liquidation value in a broken enterprise—one that is so broken it cannot function. The shareholder who seeks dissolution, too, may reasonably believe that going-concern value will not actually be lost if she remains free to compete, able to hire some of the firm's employees, and even embark on a foregone strategic course of action.<sup>244</sup>

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239. See 805 ILL. COMP. STAT. 5/12.56(e)(3) (2017) (noting that court may specify terms of share purchase, including the imposition of a covenant not to compete on the seller).

240. 805 ILL. COMP. STAT. 5/12.56(c), (e)(11) (2017).

241. 805 ILL. COMP. STAT. 5/12.56(b)(11), (e)(5) (2017).

242. *Labor Ready, Inc. v. Williams Staffing, LLC*, 149 F. Supp. 2d 398, 407 (N.D. Ill. 2001).

243. 805 ILL. COMP. STAT. 5/12.60(e) (2017).

244. *But see Jackson v. Nicolai-Neppach Co.*, 348 P.2d 9, 22 (Or. 1959) (affirming dismissal of dissolution action and noting that denial of relief “may well lead to a fairer buy-sell agreement than the remedy of enforced liquidation, a remedy which might destroy the going concern value of the plant and give both parties an unduly small return for the value of their investment.”).

Put another way, a dissolved firm will not result in the total dissipation of existing goodwill if one or more shareholders purchases key assets and continues some aspect of the business.<sup>245</sup> Using a pure economic analysis, a shareholder should choose to seek a dissolution judgment instead of a buy-out remedy if the fair value of her shares is *less than* the sum of enterprise liquidation value and potential goodwill recapture, minus any incremental litigation cost necessary to proceed with dissolution and the subsequent wind-up.<sup>246</sup>

A petitioning shareholder likely cannot make a pure economic decision on whether to proceed with a requested buy-out or dissolution, principally because she will not be able to assess two intangible factors: (1) the benefit of being free from restrictive covenants or default fiduciary-duty rules; and (2) the opportunity cost of being stuck in a dysfunctional and sinking firm. These factors may weigh more heavily in her decision than any one data point capable of rough quantification. In the unusual case where the difference between fair value and liquidation value is significant (such that the economic equation may tilt against dissolution), a petitioning shareholder retains the option to request a buy-out and the risk of having a restrictive covenant judicially ordered. The equities may prevent a court from conditioning a sale on a broad non-compete obligation, but it's nonetheless a gamble for the shareholder.

A buy-out remedy also may be insufficient for strategic business reasons, irrespective of whether a shareholder must honor a restrictive covenant. For instance, a departing shareholder (even if able to compete) may lose control of strategic assets such as key business locations, custom equipment, intellectual property, websites, and customer intangibles. Recruiting employees to leave will be a challenge (particularly if they are bound to their own individual restrictive covenants). And vendors may have to honor exclusive supply contracts with the legacy corporation. Even a buy-out at fair value may enable the incumbent shareholder to gain a tactical upper-hand by retaining some degree of control over these strategic assets, making the petitioning shareholder's job much more difficult in competing. Counting on a court to value intangible assets is a chore, to be sure, since valuation is more

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245. For a discussion concerning the tax implications of a goodwill liquidation following dissolution, see generally *Norwalk v. Comm'r*, 76 T.C.M. (CCH) 208 (1998) (distribution of accounting firm's customer-based intangibles following liquidation did not trigger gain to shareholders, since dissolved entity possessed no corporate goodwill).

246. Just how much more expensive a dissolution proceeding is, as opposed to one focused on a buy-out, is hard to say. The parties will need to factor in wind-up costs, particularly the need to pay any appointed receiver's fees. But conversely, where the petitioning shareholder seeks a buy-out, the cost of obtaining expert opinions on enterprise fair value is sure to be significant.

of an art than a science. There is, too, the element of pride. A departing shareholder may worry that third-parties will perceive her as having been ousted in unceremonious fashion.

### C. *The Partnership Analogy*

An important reference point for the dissolution remedy springs from the long-held view that a closely-held corporation is akin to a partnership.<sup>247</sup> This Article is not meant to reopen the long-simmering debate of whether partnership law should apply to facets of closely-held corporations.<sup>248</sup> The bottom line is that, in Illinois, it does.<sup>249</sup> Lawyers and litigants rightfully can debate the partnership fiduciary-duty analogy from *Hagshenas* and *Kulp*. But as I have illustrated above, Illinois fiduciary-duty law informs remedial choice, and *Hagshenas* and *Kulp* have a great deal to say about that. Because both decisions rely upon partnership law principles to vest controlling shareholders with broad fiduciary duties,<sup>250</sup> courts should examine partners' dissolution rights as authoritative when considering the proper remedy for deadlock in a closely-held corporation.

Under the Uniform Partnership Act (1997), a partner can dissolve the firm at will, meaning she can terminate the partnership simply by tendering her "express will to withdraw as a partner."<sup>251</sup> True, a partnership agreement need not be at-will; partners can contract around automatic dissolution rights—just like shareholders can through their contractual arrangements.<sup>252</sup> But the default rule applicable to true partnerships endorses dissolution absent advance contract planning, presenting partners with much more expansive remedial choice in the event of deadlock.<sup>253</sup> If partners' fiduciary duties

247. See *Doherty v. Kahn*, 682 N.E.2d 163, 175 (Ill. App. Ct. 1997) (noting that shareholders were directors and officers, and also participated in day-to-day operations of close corporation; finding that "[a]lthough Glen Regal was labeled as a corporation, it clearly was an enterprise closely resembling a partnership.").

248. Compare *Easterbrook & Fischel*, *supra* note 71, at 241-42, 249 (courts should not use partnership law to supply contractual gaps for closely-held corporations), with John A.C. Hetherington & Michael P. Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1, 3-4 (1977) (closely-held corporations are akin to partnerships, and partnership law provides better governance rules than does corporation law).

249. See *supra* text accompanying notes 225-37.

250. *Ill. Rockford Corp. v. Kulp*, 242 N.E.2d 228, 233 (Ill. 1968); *Hagshenas v. Gaylord*, 557 N.E.2d 316, 323 (Ill. App. Ct. 1990); See also *Anest v. Audino*, 773 N.E.2d 202, 209 (Ill. App. Ct. 2002) ("Shareholders in a close corporation owe to each other fiduciary duties similar to those of partners in a partnership.").

251. 805 ILL. COMP. STAT. 206/801(1) (2017).

252. 805 ILL. COMP. STAT. 206/801(2)-(3) (2017).

253. *Whalen v. Stephens*, 61 N.E. 921, 928-29 (Ill. 1901) (noting that dissolution of partnership is proper when relations would render it impracticable to conduct the business).

are indistinguishable from those held by equal shareholders in a closely-held corporation, it seems difficult to reconcile the disparate treatment nominally afforded the dissolution remedy.<sup>254</sup>

The conditions I have proposed for the dissolution remedy harmonize this disparate treatment by giving primacy to advance planning and by recognizing the unique contours of the BCA's share-purchase remedy. To be clear, I am not advocating a textual abandonment of section 12.56 or a broad endorsement of dissolution as a normal-course remedy. Indeed, dissolution upon shareholder request is presumptively appropriate only when a petitioner proves deadlock and only for corporations that lie close to partnerships (in substance if not in form). On this edge of the organizational continuum, the risk of exploitation and opportunism between shareholders is low because they actively manage the business and, absent advance planning, volitionally retain full veto power over corporate decisions.<sup>255</sup>

#### D. *Third-Party Interests*

That only leaves a final assessment of what may be the most compelling reason for declining to enter a dissolution judgment: the potential for collateral damage, such as the impact a judgment may have on innocent third-parties like employees.<sup>256</sup> This should pose less of an issue than it might appear at first blush, particularly if the parties are likely to continue with the business simply by reorganizing and recapitalizing separate entities.

To this end, the binary election-of-remedies question driven by section 12.56's text should guide a court. If a petitioning shareholder declines to elect a buy-out and is motivated by obtaining a release from a shareholder-based covenant or partnership-like fiduciary duties, then she is signaling her intent to recapture some aspect of the firm's goodwill that otherwise may be lost in a fire-sale liquidation. Any trepidation courts may face from causing third-party injury must be tempered by the reality that core pieces of the dissolved entity will resurface and rebound quickly.

Moreover, courts will need to examine any concern for non-shareholder employees in tandem with the employment at-will doctrine<sup>257</sup> and by the fact

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254. Larry E. Ribstein, *A Statutory Approach to Partner Dissociation*, 65 WASH. U. L.Q. 357, 397 (1987) (noting that partners should have judicial liquidation rights on showing of deadlock).

255. *Id.* at 380.

256. *Struckhoff v. Echo Ridge Farm, Inc.*, 833 S.W.2d 463, 466 (Mo. Ct. App. 1992) (holding that courts "should consider the effect the dissolution would have on the public as well as the shareholders."); *Jackson v. Nicolai-Neppach Co.*, 348 P.2d 9, 22 (Or. 1959) (noting public interest in preserving employment).

257. *See Michael v. Precision All. Grp., LLC*, 21 N.E.3d 1183, 1188 (Ill. 2014) (noting at-will employee may be discharged at any time and for any reason).

that few employees will want to work for what they perceive to be a sinking ship. In fact, the firm's employees may want a dissolution order, so they can pick their best landing spot – and perhaps void their own existing restrictive covenants. A remedial analysis that is excessively focused on third-party interests may fail to account for “deadwill,” or the unknowable drag that corporate dysfunction and paralysis has on entity participants.<sup>258</sup>

Courts, too, may express concern about the impact of a dissolution judgment on executory contracts, like commercial leases. Many commercial contracts provide that a corporate dissolution constitutes an event of default or will result in an automatic termination with no cure right.<sup>259</sup> For corporations that resemble partnerships, the impact on third-parties may not be particularly great if: (1) the shareholders have extended personal guaranties; (2) those shareholders are likely to pick up some aspects of the dissolved business (and therefore enter into replacement agreements); or (3) the third-party can be made whole during the corporation's wind-up process.<sup>260</sup>

#### *E. The Default Remedy Paradigm*

Since a petitioner may be motivated to avoid conduct restrictions through a potential share-purchase order, it is difficult not to see dissolution as a preferred remedy under section 12.56 for deadlock cases. But this is so only when two conditions are present: (1) the petitioning shareholder decides not to request a share-purchase remedy; and (2) the shareholders have not agreed *ex ante* in their governing contracts to a deadlock avoidance mechanism. If condition (1) is present, the responding shareholder need not make an election to purchase the petitioner's shares.<sup>261</sup> In such a case, the responding party's failure to elect a share-purchase remedy is tantamount to a concession that the corporation is not worth continuing. Absent the right to conduct an auction of the business, courts should then view dissolution as truly

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258. Relatedly, the plain language of section 12.56 places no weight on third-party interests, as it instructs a court that it may consider the *shareholders'* reasonable expectations. By omitting third-party interests, the General Assembly has not authorized a court to consider how dissolution may affect non-parties to the case. 805 ILL. COMP. STAT. 5/12.56(d) (2017).

259. *See, e.g.,* Equimark Comm. Fin. Co. v. C.I.T. Fin. Servs. Corp., 812 F.2d 141, 144 (3d Cir. 1987) (underlying portfolio agreement's event of default was petition for dissolution); Bank of Am., N.A. v. Wm. V. Schmidt Co., No. 10 Civ. 4926 (NRB), 2011 WL 1334844, at \*1 (S.D.N.Y. Mar. 25, 2011) (under business loan agreement, “event of default” included dissolution of entity as a going-concern business).

260. *See infra* text accompanying notes 272-78.

261. 805 ILL. COMP. STAT. 5/12.56(f) (2017) (providing that 90-day election right is discretionary).

the presumptive default remedy if the petitioner succeeds in proving deadlock.<sup>262</sup>

Courts, too, should adapt the concept of reasonable shareholders' expectations to the unique deadlock paradigm and the proper remedy for proven deadlock. On this score, courts should conclude that the failure to plan contractually for management deadlock amounts to a mutually-held, objective expectation that a court is the only institution capable of effectuating appropriate relief for deadlock. The absence of a deadlock avoidance mechanism in corporate planning documents, particularly when a complete remedy is available by statute, is certainly no reason for courts to avoid ordering dissolution.<sup>263</sup> The shareholders' decision to retain full management veto authority is an express grant of power for courts to step in when the exercise of that authority leads to going-concern injury. Courts are fully equipped to act as a gatekeeper when shareholders fail to contract around the possibility of management deadlock.<sup>264</sup>

In this regard, the less sophisticated the corporate planning documents (and even the parties themselves), the greater the role courts have to order relief that extricates owners from a failed endeavor.<sup>265</sup> Dissolution as a remedial device is directly proportional to how carefully those stakeholders planned for deadlock when they ordered the firm's management. If they did not, dissolution is the only remedy to fix a broken enterprise absent a petitioner's buy-out request.<sup>266</sup> Despite the superficial appeal of directorial appointments as a deadlock cure, this remedy suffers from significant limitations, not the least of which is the ongoing supervisory role a court would

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262. A responding party, too, could file a counterclaim that concedes deadlock and request that the petitioner (now the counter-defendant) buy her out for fair value. This may be a tactically unsound move, of course, if the responding shareholder wants to remain in the corporation's line of business. And it would cause the petitioner to engage in a separate decisional analysis about which remedy to seek—dissolution or a reverse of the very buy-out she sought to avoid.

263. Judges have no reason to shy away from ordering dissolution, as they often play a role in ordering litigants' contractual affairs. *See* *Martindell v. Lake Shore Nat'l Bank*, 154 N.E.2d 683, 690 (Ill. 1958) (applying implied covenant of good faith and fair dealing); *Weitekamp v. Lane*, 620 N.E.2d 454, 461 (Ill. App. Ct. 1993) (noting courts' ability to modify overbroad non-compete covenants to fit the asserted business interest at stake).

264. *See* *Thompson*, *supra* note 189, at 224.

265. *Cf.* *R&R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, No. 3803-CC, 2008 WL 3846318, at \*8 (Del. Ch. Aug. 19, 2008) (noting that the "allure of the limited liability company . . . would be eviscerated if [sophisticated] parties could simply petition this court to renegotiate their agreements when relationships sour.").

266. *See* *Israels*, *supra* note 13, at 791 (noting preference for judicial authority to permit acquisition of petitioner's stock by defendant at appraised value).

play in the firm's management and the inevitability of simply kicking the can down the road.<sup>267</sup>

Courts also have little incentive to force shareholders to remain in a dysfunctional, deadlocked organization, particularly when the proof establishes either irreparable injury to the organization or that it no longer can be conducted to the shareholders' general advantage.<sup>268</sup> If irreconcilable discord persists among the directors, then forcing the competing factions to remain bound together simply because corporations are perpetual entities yields little, if any, social benefit.<sup>269</sup> Entrepreneurs retain flexibility to choose their form of entity and almost infinite choices in structuring their planning documents.<sup>270</sup> The need to preserve the sanctity of the corporate form should not override pragmatic factors that weigh in favor of dissolution.<sup>271</sup>

#### F. *Procedural Aspects of Obtaining a Dissolution Order*

The limits of a share-purchase remedy, therefore, dramatically increase the odds that a dissolution order is the only proportional relief for true deadlock in an Illinois corporation. Obtaining a judgment, though, is only the start. Counsel for any petitioning shareholder who succeeds in her objective must understand the path that lies ahead. Several considerations must be taken into account.

*First*, it is important to distinguish between the concept of dissolution and a winding-up of the corporate affairs. Dissolution is the point at which a corporation ceases to carry on its business, and the wind-up of a business settles the corporate affairs after dissolution.<sup>272</sup> Put differently, a corporation may conduct business after dissolution only to the extent necessary to wind

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267. See *TransPerfect Glob., Inc. v. Elting* (*In re Shawe & Elting, LLC*), C.A. No. 9661-CB, 2015 WL 4874733, at \*31 (Del. Ch. Aug. 13, 2015), *aff'd*, 157 A.3d 152 (Del. 2017); Kim, *supra* note 113, at 140-41; *supra* text accompanying notes 110-30.

268. 805 ILL. COMP. STAT. 5/12.56(a)(1) (2017); see also Thomas J. Bamonte, *Should the Illinois Courts Care About Corporate Deadlock*, 29 LOY. U. CHI. L. J. 625, 644 (1998) (discussing how section 12.56's injury standard weeds out "deadlocks that are the result of the working of corporate democracy or that have little impact on the operation of the company.").

269. See McDonald, *supra* note 4, at 814.

270. See Brett H. McDonnell, *Sticky Defaults and Altering Rules in Corporate Law*, 60 SMU L. REV. 383, 384 (2007) (discussing contractarian theory and how corporate law "provides a series of convenient, off-the-rack default rules most corporations will find useful to follow most of the time."); Larry E. Ribstein, *The Uncorporation's Domain*, 55 VILL. L. REV. 125 (2010) (discussing factors that lead owners to choose between corporate and unincorporate forms, like the limited liability company).

271. See Murdock, *supra* note 74, at 441; Israels, *supra* note 13, at 793.

272. *Cole Taylor Bank v. Ratner* (*In re Ratner*), 146 B.R. 211, 216 (Bankr. N.D. Ill. 1992).

up its affairs.<sup>273</sup> Illinois law requires that the dissolved business collect its assets, discharge liabilities, and distribute what remains—either in kind or in cash—proportionate to the shareholders’ interests.<sup>274</sup>

*Second*, a wind-up raises the possibility of the court appointing a liquidating receiver. Such an appointment is entirely up to the judge who orders dissolution.<sup>275</sup> Depending on the language of any court order, a receiver would: (a) collect all assets and have the authority to sell them privately or at a public sale; (b) sue in the corporate name to collect amounts owed to the corporation; and (c) pay all liabilities.<sup>276</sup> The corporation bears the expenses associated with a liquidating receiver’s services,<sup>277</sup> so the parties (despite their disagreements) may consider trying to manage any liquidation on their own, particularly if the assets are easy to collect and administer. Of course, if the acrimony permeates the corporation, a judge may not let them attempt a wind-up.<sup>278</sup>

*Third*, a dissolution order is final and appealable under Illinois Supreme Court Rule 303.<sup>279</sup> In federal court, the doctrine of “effective finality” may render a dissolution order appealable under 28 U.S.C. § 1291 even before the actual liquidation and wind-up process begins.<sup>280</sup> Therefore, a party who believes that a court improperly ordered judicial dissolution must seek a stay of enforcement of the dissolution order (and wind-up) while the appeal is pending. Otherwise, the mechanics of a firm’s wind-up may moot the issues on review, particularly if the shareholders begin competing enterprises or if the dissolved firm’s equipment is sold to third-parties during the appeal’s pendency.<sup>281</sup>

273. *Wilhelm v. McAnn’s W. 48th St. Rest. Corp.*, No. 01 C 7518, 2003 WL 41988, at \*4 (N.D. Ill. Jan. 3, 2003) (applying New York law).

274. 805 ILL. COMP. STAT. 5/12.30 (2017).

275. 805 ILL. COMP. STAT. 5/12.60(e) (2017).

276. *Id.*

277. 805 ILL. COMP. STAT. 5/12.60(i) (2017).

278. A judge, too, may consider the parties’ ability to purchase corporate assets, such as inventory or machinery. If a third-party is more likely to pay a higher price for those assets, then the court may be more inclined to have a receiver auction them off.

279. *See Callier v. Callier*, 378 N.E.2d 405, 408 (Ill. App. Ct. 1978).

280. *See Brown Shoe Co. v. United States*, 370 U.S. 294, 304, 306, 308-09 (1962) (in challenge to merger under section 7 of the Clayton Act, concluding appellate jurisdiction existed when district court ordered acquiring company to divest itself of target’s stock and other assets even though acquirer had yet to file specific divestiture plan for court’s approval).

281. *See Kennedy v. Miller*, 528 N.E.2d 406, 408 (Ill. App. Ct. 1988) (discussing circumstances when events make it impossible for reviewing court from ordering effective relief on appeal). The parties also may want to consider seeking a stay of any dissolution order even if the losing party declines to appeal. The reasons for doing so may depend on the type of business in which the corporation is engaged. An order of dissolution may trigger an event of default under a credit facility. And a firm engaged in a regulated business, such as insurance or financial services, may face serious consequences if it is dissolved before customer accounts are transitioned appropriately. Implementing a stay in the dissolution order to enable



*Fourth*, the corporation is a necessary party to any dissolution proceeding, even if the competing shareholders/directors are adequately and fully represented.<sup>282</sup> Conceivably, the court hearing a dissolution suit could appoint counsel to represent the entity. However, it is not certain what this would achieve, other than another layer of administrative cost. Typically, corporate counsel reports to the board of directors. If that board is equally divided and truly deadlocked, counsel cannot report to it or obtain any authority to act. More likely, the corporation simply would be a nominal defendant.<sup>283</sup>

*Fifth*, the judgment order should specifically state that the court finds that none of the alternative remedies listed in section 12.56(b) is sufficient to resolve the corporation's deadlock. Though nothing in section 12.56 requires this language in a judgment order,<sup>284</sup> it is wise practice for the trial court to enter this finding on the record particularly if the matter proceeds to appeal.

## VII. CONCLUSION

The dissolution paradigm that I have proposed in this Article harmonizes not only the text of section 12.56 itself, but also the essential factors endemic to deadlock cases: the extent of advance contract planning, the availability of a share-purchase remedy, conduct restrictions, shareholder expectations, and third-party interests. The oft-repeated characterization of dissolution as an extreme remedy devolves from sources extrinsic to the unique deadlock paradigm. The better remedial analysis focuses on this paradigm and allows judges to view dissolution as an essential and entirely proper tool to resolve deadlock in closely-held firms.

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seamless client service could ameliorate the impact of a dissolution order, particularly if the principals remain in the firms' general line of business.

282. *Glickauf v. Moss*, 320 N.E.2d 132, 135 (Ill. App. Ct. 1974).

283. *See Hendley v. Lee*, 676 F. Supp. 1317, 1319 (D. S.C. 1987) (noting defendant made motion to add corporation as nominal party to dissolution proceeding); *Miller v. Miller*, C.A. No. 2140-VCN, 2008 WL 372469, at \*1 (Del. Ch. Jan. 31, 2008) (describing deadlocked corporation as "nominal defendant").

284. 805 ILL. COMP. STAT. 5/12.56(b)(12) (2017).