SUPREME COURT - STATE OF NEW YORK

Present:

HON. VITO M. DESTEFANO,
Justice

TRIAL/IAS, PART 15
NASSAU COUNTY

SAMUEL FEINBERG, individually and SAMUEL FEINBERG, a shareholder of L & E INTERNATIONAL LTD., suing in the right of L & E INTERNATIONAL LTD.,

Plaintiffs,

-against-

INDEX NO.:3120-11

ERROL SILVERBERG, VICTOR HECHT, RICK KREMER and L & E INTERNATIONAL LTD., A nominal defendant,

Defendants.

Action No.1

ERROL SILVERBERG,

Petitioner,

-against-

INDEX NO.: 7892-12

SAMUEL FEINBERG and L& E INTERNATIONAL LTD.,

Respondents.

Action No.2

The following papers and the attachments and exhibits thereto have been read on this motion:

Memorandum of Law in Support	1
Respondent's Pre-Trial Memorandum of Law	2

On August 1, 2013, the parties submitted motions in limine with respect to the hearing scheduled for September 10, 2013 in the dissolution proceeding entitled *Errol Silverberg v Samuel Feinberg and L&E International Ltd*, Index No. 7892/12. The motions address the issue of whether bad faith constitutes a defense to judicial dissolution proceedings pursuant to Business Corporation Law § 1104(a) ("BCL").

Pursuant to BCL 1104(a):

> (a) Except as otherwise provided in the certificate of incorporation under section 613 (Limitations on right to vote), the holders of shares representing one-half of the votes of all outstanding shares of a corporation entitled to vote in an election of directors may present a petition for dissolution on one or more of the following grounds:
>
> (1) That the directors are so divided respecting the management of the corporation's affairs that the votes required for action by the board cannot be obtained.
>
> (2) That the shareholders are so divided that the votes required for the election of directors cannot be obtained.
>
> (3) That there is internal dissension and two or more factions of shareholders are so divided that dissolution would be beneficial to the shareholders.

The Petitioner, Errol Silverberg, argues in his motion that, "in determining whether dissolution is proper, the issue is not who is at fault for deadlock, but whether deadlock exists. The underlying reason for the dissension is of no moment, nor is it at all relevant to ascribe fault to either party" (Silverberg Memorandum of Law at p 3). In this regard, because there is purportedly "no dispute that deadlock exits", coupled with the case law that fault for the deadlock is irrelevant, Silverberg argues that bad faith is not a defense to the dissolution of a closely held corporation with two equal shareholders, and, as such, evidence of bad faith should not be permitted at the hearing (Silverberg Memorandum of Law at pp 3, 15-20).

The following cases appear, at first glance, to support Silverberg's contention that a evidence of bad faith is not relevant to the issue of dissension and deadlock amongst two 50% shareholders.

In *Matter of Gordon & Weiss* (32 AD2d 279 [1st Dept 1969]), the First Department affirmed the Special Term's order granting dissolution of a closely held corporation holding that the good faith of the petitioner in seeking judicial dissolution pursuant to BCL 1104 did not present a contested issue requiring a hearing. In *Gordon & Weiss*, respondent argued that there was an issue as to the validity of the petitioner's application for dissolution, namely, the good

faith of the petitioner insofar as the petitioner sought dissolution in order to "squeeze out" the respondent from the business for inadequate consideration. The Second Department concluded that the commencement of the dissolution proceeding precluded that result because "[i]nstead of forcing respondent to accept an inadequate consideration for his share of the business, petitioner now applies to the court to make the distribution" (*Id.* at 280). The Court continued:

> However, this is not the complete answer to appellant's contention in regard to good faith. He contends that the real reason why petitioner seeks a dissolution is that he does not wish to continue in business with respondent. If this constitutes bad faith, he has undoubtedly raised an issue.
>
> We do not believe it does. This is a service corporation. The services for the clients are performed by the two parties to this proceeding. It is not disputed that they are not working together. The board of directors admittedly does not function because there is either a deadlock or by purposeful absence a quorum cannot meet. No significant corporate action is possible. There has been a consequent decrease in profits and loss of personnel. Regardless of which of the parties is ultimately responsible, that is the situation.
>
> * * * *
>
> It is being increasingly realized that the relationship between the stockholders in a close corporation vis-a-vis each other in practice closely approximates the relationship between partners. As a consequence, when a point is reached where the shareholders who are actively conducting the business of the corporation cannot agree, it becomes in the best interests of those shareholders to order a dissolution. The so-called issue here presented is not whether this condition exists but rather why it exists. That being of no relevance, there is no issue.

In *Matter of Kaufmann* (225 AD2d 775 [2d Dept 1996]), the Second Department affirmed the denial of a petition for dissolution where petitioner failed to demonstrate that the dissension between the parties had "resulted in a deadlock precluding the successful and profitable conduct of the corporation's affairs" and that the disagreements between the parties "posed an irreconcilable barrier to the continued functioning and prosperity of the corporation." The Court also rejected the petitioner's contention that a hearing was required because such a hearing would only have been required if "there were some contested issue determinative of the validity of the petitioner's application" (*Id.* at 776).

In *Matter of Validation Review Associates, Inc.* (236 AD2d 477 [2d Dept 1997] *rev as moot* 91 NY2d 840 [1997] [citations omitted]), the petitioner, a 60.32% shareholder of the

corporation, commenced a dissolution proceeding on the ground of dissension and deadlock in the operation of the corporation. In granting the petitioner summary judgment dissolving the corporation, the Second Department stated:

> In determining whether a petition for dissolution should be granted, the issue is not who is at fault in creating a deadlock, but whether a deadlock exists. Whether the corporation can be operated at a profit is also not determinative. The record here clearly demonstrates that there are sufficient differences and animosity between the shareholders to prevent the continued efficient operation of the corporation. It is undisputed that the shareholders have fundamental differences in opinion regarding, inter alia, the expansion and direction of VRA's business, profit distribution, salary and bonus treatment of employees, and their respective roles in the operation of the business. Under these circumstances, the petitioner was entitled to summary judgment dissolving the corporation.

Matter of Goodman ([Supreme Court Nassau County 1991] [Kutner, J.] [citations omitted]), Index No. 11304, annexed to Silverberg's motion, was a special proceeding pursuant to BCL 1104(a)(3) by one of two equal stockholders of a closely held corporation for the dissolution of the corporation. The source of the dissension was petitioner's claim that he was entitled to more than 50% of the profits for allegedly performing 100% of the work. The respondent, in contrast, claimed that the 50-50 division of profits was fair. It was undisputed that the parties had not spoken prior to the commencement of the proceeding. The sole issue before the court was whether there was internal dissension and whether two or more factions of the shareholders were so divided that dissolution would be beneficial to them. The court concluded that the record before it amply demonstrated dissension and that a hearing was not required "inasmuch as resposnent has failed to demonstrate that theere is some contested issue that would be determinative of the validity of the petition."

In affirming the *Goodman* court's order granting dissolution, the Second Department stated:

> The appellant's contention that dissolution of a corporation cannot be ordered without a hearing is without merit. A hearing is only required where there is some contested issue determinative of the application . . . .
>
> Furthermore, while it is apparent that the dissension between the shareholders in this case is the result of a dispute over profit distribution, the underlying reason for the dissension is of no moment, nor is it at all relevant to ascribe fault to either party. Rather, the critical consideration is the fact that dissension exists and has resulted in a deadlock precluding the successful and profitable conduct of the corporation's

affairs. The record amply demonstrates sufficient dissension among the parties to direct dissolution.

As noted by the Supreme Court, the shareholders do not dispute that they have not spoken with each other since October 31, 1990, when they had a disagreement over how corporate profits should be allocated. The record clearly demonstrates there are sufficient differences and animosity between the shareholders to prevent the continued efficient operation of the corporation. Therefore, under the circumstances, dissolution is the only viable alternative (*Matter of Goodman v Lovett*, 200 AD2d 670 [2d Dept 1994] [citations omitted]).

In the First Department case of *Matter of Neville v Martin* (29 AD3d 444 [1st Dept 2006]), the Court affirmed an order granting dissolution pursuant to BCL 1104(a)(2) on the ground that the evident dissension between the 50% shareholders "left no doubt that the corporation count not continue to function effectively." Notably, the court ordered dissolution notwithstanding the fact that the dissension did not have "appreciable impact" on the firm's profitability. And relying on *Matter of Gordon & Weiss* (32 AD2d at 279, *supra*), the Court ordered the dissolution without a hearing "[s]ince there was no real dispute that dissension and deadlock existed" (*Id.* at 445).

And recently, in *Matter of Dream Weaver Realty, Inc.*, 70 AD3d 941, 942 [2d Dept 2010]), the Court affirmed the Supreme Court's order granting dissolution, finding that no hearing was warranted as there was "no genuine dispute as to the existence of deadlock and dissension." The evidence before the court in *Dream Weaver* demonstrated that the dissension between two equal 50% shareholders "posed an irreconcilable barrier to the continued functioning and prosperity of the corporation". According to the Second Department:

"In determining whether dissolution is in order, the issue is not who is at fault for a deadlock, but whether a deadlock exists. "[T]he underlying reason for the dissension is of no moment, nor is it at all relevant to ascribe fault to either party. Rather, the critical consideration is the fact that dissension exists and has resulted in a deadlock precluding the successful and profitable conduct of the corporation's affairs". Here, the record amply demonstrates sufficient dissension among the parties, resulting in a deadlock, so as to warrant dissolution

Moreover, "[a] hearing is only required where there is some contested issue determinative of the application." Here, the court properly granted the petition without a hearing, as there was *no genuine dispute as to the existence of deadlock and dissension* (*Id.* [citations omitted] [emphasis added]).

At bar, the Respondent, Samuel Feinberg,[1] argues in his motion that Silverberg will not be able to meet his burden that: 1) grounds exist for the judicial dissolution of L&E International Ltd ("L&E"); 2) that dissolution would be in the best interests of both Silverberg and Feinberg;[2] or that the dissension between the parties has created an irreconcilable barrier to the continued function and prosperity of L&E. Feinberg also asserts that, regardless of Silverberg's success in establishing prima facie entitlement to dissolution of L&E, the petition for dissolution was filed in bad faith, which, according to Feinberg, "is an absolute bar to dissolution" (Feinberg Memorandum of Law at pp 13-15).

Specifically, with respect to Feinberg's contention that the petition for dissolution was filed in bad faith, Feinberg argues that the "acts committed by Silverberg to demean Feinberg and cut off Feinberg's finances caused the dissension between Silverberg and Feinberg, enabling Silverberg to plead in his Petition that parties are in deadlock over compensation and management of L&E's affairs. In other words, Silverberg created the very basis for the dissension, in order to obtain control over L&E's business through dissolution, without paying Feinberg the fair market value for Feinberg's ownership interests in L&E as a going concern" (Feinberg Memorandum of Law at p 19).

Feinberg cites the following cases in support of his argument that Silverberg's bad faith in creating the dissension and instituting the instant dissolution proceeding is a defense to judicial dissolution. First, in *Kavanaugh v Kavanaugh Knitting Co.* (226 NY 185 [1919]), the Court of Appeals reversed the lower courts' dismissal of a complaint which alleged that the defendants' resolution to dissolve the company and institute a dissolution proceeding was not the result of a bona fide and honest consideration of the company's interests but rather, was done in bad faith and for the sole purpose of permitting the individual defendants to dissolve the company. According to the Court,

> The plaintiff's complaint is that the individual defendants who were the board of

---

[1] Samuel Feinberg is the Plaintiff in *Samuel Feinberg, individually and Samuel Feinberg, a shareholder of L & E International Ltd., suing in the right of L & e International Ltd., v Errol Silverberg, victor Hecht, Rick Kremer and L & E International Ltd., a nominal defendant*, Index No. 3120-11 which has been joined with the instant dissolution proceeding.

[2] According to Feinberg, dissolution is not warranted under BCL 1104(a) because the "management of L&E is neither paralyzed nor frozen - and despite the alleged dissension between Silverberg and Feinberg, L&E had been able to operate its business on a day-to-day basis and in an overwhelmingly profitable manner" (Feinberg Memorandum of Law at p 13).

directors did not form the opinion that it was advisable to dissolve the corporation forthwith in good faith and through honest intention and endeavor. We need not state a detailed analysis of the contents of the complaint. Obviously, facts are alleged which permit, if they do not compel, the inference that the directors conceived and progressed the scheme of dissolving the corporation, irrespective of the welfare or advantage of the corporation and of any cause or reason related to its condition or future, through the desire and determination to take from the corporation and to secure to themselves the corporate business freed from interference or participation on the part of the plaintiff. Moreover, allegations of the complaint are, in effect, that the judgment or opinion of the directors was not honest, their action was not the result of good faith, the exercise of an honest judgment and an honest and unbiased consideration of any fact or circumstances affecting the general interests of the corporation and of all of its stockholders, and was in bad faith and for the sole purpose of permitting the individual defendants Kavanaugh to dissolve the corporation for the purpose of depreciating the value of the corporate property and the plaintiff's proportionate interest therein. Those allegations are matters of fact (Id at 197-98).

In *Matter of Myers v Gold* (77 AD2d 652 [2d Dept 1980]), a dissolution proceeding brought pursuant to BCL 1104(a)(3), the Second Department held that a hearing was "necessary to determine whether the alleged dissension between the parties within their closely held corporation makes continued association unworkable and whether the continuance of the corporate business no longer is advantageous to the shareholders. Allegations of petitioner's bad faith constitute a defense to a dissolution proceeding and must be heard by Special Term as well."

The Third Department analysis of bad faith in *Matter of Eklund Farm Machinery, Inc.* (40 AD3d 1325 [3d Dept 2007]), is also instructive. In *Eklund Farm Machinery*, the Supreme Court found that the dissension amongst the shareholders was "patently obvious" and granted, without a hearing, the petition for dissolution pursuant to BCL 1104(a)(3). On appeal, the respondents argued that there was a "question of fact as to whether petitioners had acted in bad faith by creating dissension solely to compel dissolution." Acknowledging the merit in respondents' argument, the Third Department stated:

> *While it would certainly be appropriate to deny summary dissolution under Business Corporation Law § 1104 (a) (3) where one shareholder faction intentionally creates a dispute which may not be genuinely irreconcilable*, the record would not support such a conclusion here. EFM has been under the sole control of respondents, petitioners have been excluded from the management and records of the corporation, and petitioners derive no benefit whatsoever from their shares. Nor do petitioners

> have any immediate prospect of selling the shares due to restrictions on their transferability. As a result, even if petitioners were shown to have created dissension to obtain dissolution, Supreme Court could not conclude that it was in bad faith or that the parties' differences were reconcilable. Given these circumstances, "the underlying reason for the dissension is of no moment" and a judicial remedy is appropriate.

(*Id.* at 1326-27 [citations omitted] [emphasis added]; *compare Cassata v Brewster-Allen-Wichert, Inc.*, 248 AD2d 710 [2d Dept 1998] [parties' affidavits presented disputed issues of fact with respect to the claim by majority shareholders that the minority shareholder's actions were undertaken with a view toward forcing a judicial dissolution, pursuant to BCL 1104-a, in order to aid a competing company in which the minority shareholder had a financial interest and, as such, a hearing was required with respect to the majority shareholders' defense of bad faith]).

Upon a careful analysis of both parties' arguments, as well as the cases which purportedly support their respective contentions, the court concludes that the cases and legal arguments, while at first blush appear to be contradictory, can, in actuality, be harmonized. The common thread permeating throughout the cases relied upon by Silverberg is that the courts ordered dissolution without the need for a hearing because there was no real dispute that dissension and deadlock existed between the shareholders. The fact that there was bona fide dissension and deadlock, in and of itself - and regardless of fault - was sufficient for the courts to order dissolution in the absence of a hearing.

A review of the cases cited by Feinberg demonstrate, however, that the dissension and deadlock was not in fact real, but, rather, feigned. It is this manufactured creation of the dissension which, in this court's view, is the *sine qua non* of bad faith and its applicability as a defense to a judicial dissolution proceeding brought pursuant to BCL 1104(a). Simply put, in determining whether to order dissolution, while fault is of no moment when dissension and deadlock actually exist, the intent, in contrast, for creating dissension and deadlock is nevertheless relevant (*see Kavanaugh v Kavanaugh Knitting Co.*, 226 NY 185 [1919] [citations omitted] ["Motive and intent are not, in law, synonymous. . . . 'In the popular mind intent and motive are not infrequently regarded as one and the same thing. In law there is a clear distinction between them. Motive is the moving power which impels to action for a definite result. Intent is the purpose to use a particular means to effect such result.' Good faith or bad faith or intent when constituent and essential in a cause of action or defense is a fact and may be alleged and proved as such]). Here, a manufactured dissension would belie a finding that the shareholders' dissension poses an irreconcilable barrier to the continued functioning and prosperity of the corporation (see *Matter of Eklund Farm Machinery., Inc.* 40 AD3d 1325 [3d Dept 2007] [where one shareholder faction intentionally creates a dispute which may not be genuinely irreconcilable, summary dissolution, in the absence of a hearing, would be improper]).

Given Feinberg's allegations, this court, which sits in both law and equity, would not permit a party to avail itself of the legal system to achieve an inequitable result (*see Cassata v Brewster-Allen-Wichert, Inc.*, 248 AD2d 710 [2d Dept 1998] [minority shareholder's acts done in "bad faith and undertaken with a view toward forcing an involuntary dissolution [pursuant to BCL 1104-a]. . . is not entitled to redress under the statute"]).

Accordingly, insofar as the court will permit evidence at the hearing related to Silverberg's purported bad faith in creating dissension and deadlock, it is hereby

Ordered that, Respondent, Samuel Feinberg, is permitted to seek leave of court, by order to show cause, for disclosure on the issue of bad faith as outlined herein (CPLR 408). [3] The order to show cause must be served no later than September 16, 2013. Petitioner, Errol Silverberg, shall, within eight days thereof, submit opposition to the motion; and it is further

Ordered that the hearing scheduled for September 10, 2013 is hereby adjourned until November 6, 2013.

This constitutes the decision and order of the court.

DATE: September 6, 2013

Hon. Vito M. DeStefano, J.S.C.

[3] The court notes that the Consent Order dated June 28, 2013 contemplates discovery, most of which is extraneous to the instant dissolution proceeding and the limited issue of bad faith.