

## QUESTIONS PRESENTED

**Question 1:** Where members of a limited liability company have not executed a written agreement concerning allocation of profits, should the members voting rights be determined on the basis of the ratio of entitlements to revenue?

**Answer:** The trial court erred when it answered this question in the affirmative.

**Question 2:** Is a member of a limited liability company's entitlement to less than a majority of the company's net revenue a sufficient basis to deny her petition for judicial dissolution of the company pursuant to Limited Liability Company Law § 702?

**Answer:** The trial court erred when it answered this question in the affirmative.

## PRELIMINARY STATEMENT

In 2009, Petitioner-Appellant, Dina DiCenso (DiCenso”) and Respondent-Respondent, David Wallin (“Wallin”) decided to create a business. The business was to be a tattoo parlor that also sold merchandise, held art shows, and conducted other business activities. The parties’ economic deal was that after the payment of the businesses expenses Wallin would be entitled to keep 100% of the revenue attributed to tattooing he performed. DiCenso was entitled to receive 30% of the gross revenue associated from merchandise sales and guest tattoo artists. (A guest tattoo artist is a tattoo artist that temporarily performs tattooing services in the business’s location.) The parties, however, were to have equal rights to manage and control the business.

The parties named their business Eight of Swords Tattoo. They filed Articles of Organization for an entity they named “Eight of Swords, LLC” with the New York Secretary of State, but never prepared or executed an Operating Agreement or otherwise reduced their business deal to writing. In July 2009, Eight of Swords Tattoo opened for business at 178 North Eight Street in Williamsburg, Brooklyn.

Unfortunately, the parties’ relationship quickly deteriorated and by February 2010, Wallin was attempting to exclude DiCenso from the business. On April 23, 2010, DiCenso filed a Petition to dissolve Eight of Swords, LLC, pursuant to

Limited Liability Company Law § 702, in the Kings County Supreme Court. Wallin served an Amended Answer and Counterclaims on June 11, 2010. Thereafter, the trial court (Carolyn Demarest, J.) heard several days of testimony.

On January 13, 2011, the trial court entered its Order deciding the case (the “Order”) (R. 3.) (The Order was entered in the Kings County Clerk’s Office on February 8, 2011). The Order denied DiCenso’s motion to dissolve Eight of Swords, LLC and dismissed the Petition holding that the business purpose of Eight of Swords, LLC has been met and continues to be met and can continue to be met under the operation and management by Wallin. The Order then continued that DiCenso did not have the authority to go to the business, run it or manage it in any way. Finally, the Order provided that DiCenso’s interest in Eight of Swords, LLC was “certainly less than 20% and may be as little as 1% to 5%.” (R. 3-4).

This was error. The Court’s fundamental error was to assume that because Eight of Swords, LLC had substantially more revenue attributable to Wallin’s tattooing than to merchandise sales and guest artists, the result was that Wallin would control the business.

The limited liability company law provides that in the absence of another agreement voting rights are to be based upon the members’ right to *profits*. Limited Liability Law § 402. The Limited Liability Company Law, however, makes a clear distinction between *profits* and *distributions*. Compare Limited

Liability Company Law § 503 *with* Limited Liability Company Law § 504. The parties' agreement that gave Wallin 100% of the revenue associated with his tattooing and DiCenso 30% of the gross revenue from merchandise sales and guest artist concerns *distributions*, not profits.

With respect to profits, Limited Liability Company Law § 504 provides that in the absence of an agreement, profits should be allocated on the basis of the parties' contributions to the business that were not returned to the member. The Court below erred when it ignored Ms. DiCenso's contributions to the business and failed to consider that Wallin was receiving a paycheck for his tattooing, but DiCenso was not receiving *any* income from the business.

Thus, the Court used the wrong methodology to determine how Eight of Swords would be managed. In fact, as DiCenso testified, the parties were to share in management decisions and each had a fifty percent interest in Eight of Swords, LLC for purposes of management and control of the business. Revenue allocation had no impact on management and control.

For this reason, the Court erred when it held that DiCenso had no management rights, that its business purpose could continue to be met and that Eight of Swords, LLC should not be dissolved. Accordingly, this Court should reverse the trial court and Order that Eight of Swords be dissolved and that its affairs be wound-up.

## STATEMENT OF FACTS

In or about May 2009, DiCenso and Wallin agreed to create Eight of Swords, LLC (the “Company”). The Company’s business purpose was to operate Eight of Swords Tattoo, a tattoo parlor and store that sold retail merchandise, primarily, jewelry, clothing, and wares. Wallin, a licensed tattoo artist would perform his services for the Company and the Company would also invite guest tattoo artists to tattoo at the business. (R, 72-74.)

In exchange, the business would collect a percentage of the fees the guest tattoo artists charged their clients. The parties also agreed to hold periodic art shows at the business and to take a portion of the price paid for any artwork purchased at the art shows. DiCenso, who is not a licensed tattoo artist agreed to contribute her expertise in business operations to the Company. DiCenso capitalized the Company with a loan of approximately \$31,000, signed the Company’s lease in her capacity as “managing member” and personally guaranteed the lease. (R. 74-78, 582-583, 588-606.)

The parties agreed that the revenue attributable to the business would be divided according to their areas of expertise. Specifically, the parties decided Wallin, after payment of the Company’s expenses, would be entitled to all revenue attributable to tattooing work that he personally performed. DiCenso would contribute her business acumen to the venture. In exchange, DiCenso would be

entitled to receive 30% of the Company's gross revenue attributable to merchandise sales and fees received from guest artists. (R. 74-74, 90-91,582.)

The parties filed Articles of Organization for the Company with the New York Secretary of State, but the parties did not execute an Operating Agreement or any other documents governing the management and control of the Company. Eight of Swords Tattoo opened for business in July 2009 at 178 North Eight Street in Williamsburg, Brooklyn. The business was capitalized virtually entirely by DiCenso's \$31,000 loan from DiCenso, which was payable at a mere 5% simple interest rate over five years in the amount of \$589 per month. Wallin provided virtually no capital to the Company whatsoever. (R. 14, 18-19, 48-49, 74-75, 88, 112-14.)

DiCenso spent considerable time and energy preparing to open the business performing virtually all of the administrative and management tasks as well as providing physical labor building out Eight of Swords Tattoo's location. DiCenso never received compensation for any of this work. Upon the business's opening Wallin became a W-2 employee and received a paycheck and health insurance from the Company. DiCenso was never an employee of Eight of Swords, LLC and never received a dime of compensation except for some of her monthly loan repayments. (R. 84, 88, 112-114.)

After the Company began its operations DiCenso and Wallin became locked into a series of disputes. There were disputes about who had the authority to engage guest artists; there were disputes about accounting issues; there were disputes about whether Wallin was properly supporting the businesses ventures other than his own tattooing; there were disputes about DiCenso's right to be physically present at the business's location at 178 North Eighth Street, in Williamsburg. In short, the parties could agree on nothing. By February 2010 Wallin attempted to bar DiCenso from the business. (R. 14, 493-94, 502, 569-70.)

### **THE PROCEEDINGS BELOW**

On April 2, 2011, DiCenso commenced a special proceeding for dissolution of Eight of Swords, LLC pursuant to Limited Liability Company Law § 702 in the Kings County Supreme Court. DiCenso sought dissolution of the Company and an accounting. Wallin served an Amended Answer and Counterclaims. Among other things, Wallin sought a judicial declaration that he was the 100% Owner of Eight of Swords, LCC. (R 13-58.)

The parties tried the matter to the court below on several dates throughout 2010. During the trial the evidence demonstrated that while the parties had a basic agreement concerning the distribution of revenue from the business, their testimony on the right of each party to participate in the management and control of the business differed sharply. DiCenso testified that the agreement was that she

“would manage the business and [Wallin] would tattoo.” (R. 125.) Indeed, when the trial court asked Ms. DiCenso, “And how much of the LLC itself do you think you own?” Ms. DiCenso answered, “It’s my understanding we are 50/50 partners. So I have been in charge of the business.” (R157-58, *see also* R 73.) Wallin, on the other hand, tried to claim that “it was [his] tattoo studio and [he] made all the decisions.” (R. 547.) But Wallin admitted that the “idea was that [he] and Ms. DiCenso to [sic] open the shop together.” (R. 160.) Wallin also admitted that he “opened the shop “with Ms. DiCenso.” (R. 564.)<sup>1</sup>

At the conclusion of the trial, the court below made its decision from the bench which it subsequently embodied in the Order. Applying the standard set forth in *1545 Ocean Ave. LLC v. Van Houten*, 72 A.D.3d 121, 893 N.Y.S.2d 590 (2<sup>nd</sup> Dep’t 2010), the trial court concluded that the Company should not be dissolved because “the business purpose has been met, and continues to be met, and can continue to be met under the operation and management by Mr. Wallin as the managing member.” (R. 583-84.) This appeal followed.

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<sup>1</sup> DiCenso’s husband, Michael Szarek, supported DiCenso’s testimony, stating, DiCenso “founded the business.” (R. 530.)



## ARGUMENT

- I. **The trial court erred when it concluded that DiCenso had a minority interest in Eight of Swords, LLC because she received less of its revenue.**

The Limited liability Company Law provides that, in the absence of an agreement to the contrary, members in a limited liability company vote in proportion to their share of the limited liability company's current profits. Specifically Limited Liability Company Law § 402 provides

Except as provided in the operating agreement, in managing the affairs of the limited liability company, electing managers or voting on any other matter that requires the vote at a meeting of the members pursuant to this chapter, the articles of organization or the operating agreement, each member of a limited liability company shall vote in proportion to such member's share of the current profits of the limited liability company in accordance with section five hundred three of this chapter.

Limited Liability Company Law § 402(a).

Section 503 of the Limited Liability Company Law provides that:

The profits and losses of a limited liability company shall be allocated among the members, and among the classes of members, if any, in the manner provided in the operating agreement. If the operating agreement does not so provide, profits and losses shall be allocated on the basis of the value, as stated in the records of the limited liability company if so stated, of the contributions of each member, but not including defaulted obligations to make contributions, to the extent they have been received by or promised to the limited liability company and have not been returned to any such member.

Limited Liability Company Law § 503.

In contrast, a Limited Liability Company member's right to receive distributions is addressed in Limited Liability Company Law § 504, which provides:

Distributions of cash or other assets of a limited liability company shall be allocated among the members, and among classes of members, if any, in the manner provided in the operating agreement, which may, among other things, establish record dates for distributions. If the operating agreement does not so provide, distributions shall be allocated on the basis of the value, as stated in the records of the limited liability company, if so stated, of the contributions of each member, but not including defaulted obligations to make contributions, to the extent they have been received by or promised to the limited liability company and have not been returned to any such member.

Here, the trial court conflated "profits" and "distributions." The parties agreed to split the revenues of the company in a manner such that Wallin was entitled to receive 100% of the revenue, after payment of expenses, associated with his tattooing and DiCenso was entitled to 30% of the gross revenues from merchandise sales and guest artists. But that was not the agreement on profits or management and control.

With respect to profits and management and control, the testimony was in conflict and no records were presented. Under these circumstances, the court

should have compared the value of the parties' contributions to the company. In so doing the Court should have considered the following facts:

1. DiCenso provided substantially all of the capital to the Company in the form of a low interest loan to a start-up retail business in a downward-turning economy.
2. DiCenso personally guaranteed the Company's lease, but Wallin did not.
3. Wallin received a paycheck and was a W-2 employee; this represented a return of the contribution Wallin made to the company through his tattooing services.
4. DiCenso made substantial contributions to the Company for which she never received any compensation by performing virtually all of the administrative and management tasks as well as providing physical labor building out the Eight of Swords Tattoo's location.

These facts demonstrate that DiCenso's contributions to the Company were significant. Given DiCenso's significant contribution to the business, the court below should not have resorted to determining DiCenso's contribution on the basis of her right to receive revenue. Rather, the Court should have accepted DiCenso's testimony that the parties agreement was that the business was to be managed and controlled by her and Wallin equally.

This arrangement is the only arrangement that makes any sense. Ms. DiCenso would not have loaned \$31,000 to a start-up retail business in a deteriorating economy at a mere five percent without some rights of control. She would not have personally guaranteed the Company's lease, and would not have performed significant uncompensated services unless she was going to have rights to manage the business. Indeed, Wallin admitted as much. He testified that he and DiCenso opened the shop "together") (R. 160, *see also* R. 564.)

This is also consistent with Wallin's status as a W-2 employee of the Company. By virtue of his status as a W-2 employee, the Company would expense the bulk, if not all, of Wallin's compensation. This would result in distributions to Wallin that would be much closer to the distributions that DiCenso was entitled to receive from the income attributable to merchandise sales and guest artist revenues.

For all these reasons, the court below erred when it determined that DiCenso did not have the right to participate in the management and control of Eight of Swords, LLC.

**II. Because DiCenso was excluded from control of the Company the trial court should have dissolved Eight of Swords, LLC.**

The standard for judicial dissolution of a limited liability company is set forth in *1545 Ocean Ave. LLC v. Van Houten*, 72 A.D.3d 121, 893 N.Y.S.2d 590 (2<sup>nd</sup> Dep't 2010). In *1545 Ocean Ave.*, this Court dismissed a petition for dissolution of a limited liability company managed by two managers pursuant to an operating agreement. In denying the petition for dissolution, this Court held:

“the petitioning member must establish, in the context of the terms of the operating agreement or articles of incorporation, that (1) the management of the entity is unable or unwilling to reasonably permit or promote the stated purpose of the entity to be realized or achieved, or (2) continuing the entity is financially unfeasible.”

*1545 Ocean Ave., LLC*, 72 A.D.3d at 131.

Here, because the court below determined that DiCenso had a minority interest in the Company, it misapplied the *1545 Ocean Ave.* test. Only by first assuming that DiCenso's interest in the Company was a minority could the court below conclude that the stated purpose of the Company was being achieved. Had the court below concluded, that both DiCenso and Wallin were to share management and control of the company, it would have seen that once Wallin excluded DiCenso from management and control, the stated purpose of the Company was not met. That is because the purpose of the Company was not just

to open a tattoo parlor, but to open a business offering tattooing, merchandize, art shows, and guest tattoo artists *that both owners would jointly run*.

The *1545 Ocean Ave.* court refused to dissolve a limited liability company on the basis of deadlock. But there are a number of facts that distinguish *1545 Ocean Ave.* from this case. First, in *1545 Ocean Ave.*, the petitioner's objection was limited to construction costs. Second in *1545 Ocean Ave.* the petitioner had the option of voiding the construction contract. Third, in *1545 Ocean Ave.*, the Petitioner had the potential remedy of a derivative claim. Here, by contrast none of the options in *1545 Ocean Ave.* are available. None will restore DiCenso's right to participate in management and control of the business. For this reason, even though the standard articulated in *1545 Ocean Ave.* applies, the facts here demand a different result.

## CONCLUSION

For all the reasons set forth herein, the Court should reverse the decision of the trial court and hold that because it is not reasonably practicable to carry on the business as its owners intended, Eight of Swords, LLC should be dissolved.

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