Breaking Up (a Business) Is Hard to Do: How to Plan Ahead to Ease the Pain

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In business, as in marriage, financial problems put stress on a relationship and are a common cause of divorce. No business divorce is easy, but partners who have ahead of time vetted governance, dispute resolution, termination and exit provisions stand a better chance of an easier, less expensive separation. But regardless of how extensively partners consider issues before entering into a business relationship, unforeseeable circumstances — like the current COVID-19 pandemic — can present scenarios that even the smartest, most prescient minds may not have anticipated. Even still, a thoroughly negotiated and well-drafted agreement can help parties to avoid or simplify litigation and make the outcome more predictable.

The Delaware Chancery Court's Decision in Mehra v. Teller*[1]*

A recent decision from the Delaware Chancery Court highlights how an amiable and profitable business relationship can quickly sour, and how, in the absence of carefully thought through pre-negotiated terms, pre-defined exit strategies and agreed-upon dispute resolution provisions, a court's ruling can leave both parties feeling unhappy. *Mehra V. Teller* involved a dispute over the dissolution of EOS Investor Holding Company, LLC (Holdco), a consumer goods company, owned and controlled by Jonathan Teller and Sanjiv Mehra. Teller founded Holdco and hired Mehra to manage the company. Teller controlled 85% of Holdco's equity, and Mehra controlled 15%, but because of Mehra's increasing responsibility for the company's day-to-day management, over time through amendments to Holdco's LLC Agreement, the partners agreed that Mehra would have equal say over both and board decisions and an equal right to distributions above a threshold amount.

For several years, Holdco prospered, and the business and personal relationships between Teller and Mehra thrived. They shared an office, enjoyed working together and were good friends outside of work. But when Holdco faced certain business challenges, including a class-action lawsuit, difficulties in expanding into international markets and a lack of cash flow, the relationship became strained. As the partners' business and personal relationships endured more stress and began to fracture, they looked to the LLC Agreement to guide their separation. Teller, as the majority owner, wanted to remove Mehra from Holdco; however, the LLC Agreement required unanimity in this decision, which was an impossibility since Mehra would not vote for his own ouster. The LLC Agreement did provide a remedy for deadlock, but that remedy was draconian in that it called for dissolution of Holdco. Holdco, however, owned a subsidiary that was the operating company for the business and the dissolution provision also required that upon dissolution and distribution of the assets of Holdco to the members, the parties replicate the same rights to equal distributions that existed at Holdco. Teller, knowing that the LLC Agreement's remedy for deadlock was dissolution, nonetheless called a vote on Mehra's removal, declared a deadlock, and dissolved the company. He did not, however, replicate the same rights for Mehra in the operating company. Mehra sued to challenge the dissolution decision and the company's unequitable distributions.

To resolve the parties' dispute, the Delaware Chancery Court needed to decide whether a deadlock had, in fact, occurred. Mehra, who recognized the consequence of voting against his own removal from the company, refused to vote on the issue and argued that a deadlock did not exist and therefore that the dissolution was improper. The LLC Agreement did not define when a deadlock occurred, necessitating the court to look to Delaware law. Further, the court considered whether Teller could contrive a deadlock for the purpose of dissolving the relationship.

The court began its analysis by acknowledging the fundamental principle that LLC agreements – like other contracts – are objectively interpreted through consideration of the language chosen by the parties, viewed in totality, with effect given to all provisions. In this instance, since the LLC agreement did not address what constituted a "deadlock," the court looked to statutory guidance and precedent to define the term. That authority provides that, absent being otherwise defined within a LLC agreement, a deadlock exists where a voting threshold is not satisfied because of insufficient affirmative votes, with abstentions recorded as no votes. From this interpretive guideline it was concluded that a deadlock existed and Teller's right to dissolve the company was upheld. But the court ruled that Mehra proved that Teller had breached his obligations to replicate Mehra's rights to equal distribution. Thus, the litigation and litigation expense will continue for the parties for the foreseeable future.

Drafting Issues

In retrospect, it is easy to see the benefits of negotiating a detailed agreement between partners to a joint venture or strategic alliance. Joint ventures and strategic alliances are among the toughest arrangements to negotiate as they are similar to negotiating a pre-nuptial agreement. The parties are negotiating a deal during the courtship and honeymoon stage but are planning for the divorce. Although it is impossible to anticipate every scenario that may lead to a business divorce, there are common fact patterns and drafting strategies that should be considered.

Partners negotiating a joint venture or strategic alliance should carefully consider and resolve corporate governance issues. Giving partners equal voting rights makes sense when times are good and everyone is agreeable. But how does a decision get made when the company is under stress, money is tight, and the partners cannot agree on the company's future direction? What types of issues should be considered as likely or intended to cause a deadlock, which can force the dissolution of the business? Before dissolution, do the parties want to submit their dispute to mediation or arbitration, recognizing that the process is not always expeditious and will likely leave one or both sides discontent with the result? Do the parties want to provide for a tie-breaker vote where on certain issues one party has a "super-vote" to override the deadlock? Should one or both parties be permitted to require or force a buy-out of the other or sale to the other of its interest in the venture or force a sale of the entire business? If so, what terms should apply and how should the company be valued? If litigation ensues, where should the case be filed and what law should apply? In lieu of litigation, is it better for the parties and their future business interests to submit to their dispute to a confidential arbitration?

Even when individuals or companies thoughtfully consider and agree to issues before they begin their joint venture or strategic alliance, some scenarios may not be addressed. Alternatively, compliance with agreed-upon provisions may not be easy or strategically advantageous to one or both parties. But such are the things that lawsuits are made of. Nonetheless, a thoroughly negotiated and well-drafted agreement provides both the parties and the court/arbitrator with a clear framework to resolve future disputes.

Litigation Issues

Experienced commercial litigators know and appreciate the benefit of having comprehensive and clearly drafted agreements when litigating disputes between or among business partners. The law in many states, including Delaware in its Limited Liability Company Act implicated in *Mehra*, gives parties a wide latitude in setting the parameters of their business relationship. When during their courtship business partners negotiate and agree upon terms regarding governance, dispute resolution and exit strategies — regardless of the chosen path — the business divorce can be substantially easier and less expensive if there is a clear roadmap, even if it is accomplished through litigation.

Having a thorough agreement embodying the mutual intent of the parties at the inception of their business relationship increases the predictability of the outcome of a business divorce. Delaware is a strict construction state and will hold the parties to the clearly expressed terms of their contract. As shown in *Mehra*, terms that the parties do not expressly address will be supplied by statute and

precedent, and its application may produce a result that neither party anticipated or desires. Without guidance from the parties of their mutual intent, a court may be left with no alternative under statutory law but to order the dissolution of the business, which may be the worst-case scenario for all involved.

Conclusion

Entering into a business relationship is like entering into a marriage, and while the parties hope for harmony and success at the courtship stage, in a business relationship parties should plan for potential disharmony and discord. Parties' goals, requirements and objectives change over time and can be influenced by a myriad of external factors that are hard to predict when everyone is excited about the possibilities of the venture. Negotiating and drafting business agreements for joint ventures and strategic alliances are difficult tasks, especially at a time when they certainly want to direct their energies toward launching their new business. But the failure to plan can exacerbate the ability to resolve future disputes. Moreover, the failure to plan can result in a court mandating a result that neither side wants at a price that neither side was prepared to pay.

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[1] *Teller v. Mehra,* No. 2019-0812-KSJM (Del. Ch. Jan. 29, 2021).

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