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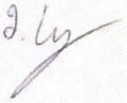
Signature: 

Corporate "Deadlock" Breaking Mechanisms in Close Corporations

By

Mariam Samushia

A thesis submitted to fulfillment of the requirements for the degree of

Master of Comparative Private and International Law

At the

New Vision University

Supervised by Professor David Kereselidze

September, 2021

Abstract

The present thesis refers to the deadlocks arising in closely held corporations, which initially cause corporate impasse, a high degree of probability may cause irreparable financial or other kinds of damages, and may ultimately lead to the worst possible consequences for the corporation – dissolution. Through the analysis of the legislation and case law of the USA the author in the first place will try to expound the true essence of deadlocks based on the precedents of significant USA court practices, then will outline the mechanisms for breaking corporate deadlocks, will demonstrate the methods of avoiding corporation stalemates and try to reveal the differences between the true and manufactured deadlocks.

The author also will review and critique several decisions made by Supreme court of Georgia in regard to corporate deadlocks in closely-held corporations. The next chapter is devoted to the new "Law on Entrepreneurs of Georgia" adopted by the Parliament of Georgia on August 2, 2021, which enters into force on January 1, 2021 and its relation to international standards, especially USA case law practice.

Consequently, the paper represents a problem which pretty nearly has not yet been answered in Georgian legal literature. The present thesis has practical usefulness for practicing lawyers along with any person interested in the topic.

List of used abbreviations:

Ch. Chapter

Del. Delaware

ED. Edition

E.G. Exempli Gratia (for example)

Etc, Et Cetera

Id. Idem (the same)

Leg. Legislation

Mass. Massachusetts

No. Number

P. Page

URL. A Uniform Resource Locator

Vol. Volume

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1. Introduction

The concept of "Homo Economicus" origins from John Stuart Mill. His essay was published in 1836 and titled as "On the Definition of Political Economy and on the Method of Investigation Proper to It", which subjects a "being who desires to possess wealth, and who is capable of judging the comparative efficacy of means for obtaining that end."[1] On the contrary, Herbert Simon introduced (in 1982) the theory of "bounded rationality" against neoclassical economics and his call to replace the perfect rationality assumptions of Homo Economicus with a conception of rationality tailored to cognitively limited agents.[2] The main essence of this theory is that "perfect" rationality to account for the fact that perfectly rational decisions are often not feasible in practice because of the intractability of natural decision problems and the finite computational resources available for making them.[3] The author shares theory about humans' "bounded rationality", thus corporate deadlock should be considered as the best illustration of the foregoing theory.

Among the various definition which exist with regard to the concept of corporate deadlock, practically all of them refer to a situation in which there are two opposing parties with an equal legal power, being in a hostile relationship with each other. In such an instance, progress is

[1] "Homo Economicus", James Chen, reviewed by Charles Potters, Updated Jul 31, 2021; URL = https://www.investopedia.com/terms/h/homoeconomicus.asp Last Seen: 05.09.2021

[2] "Bounded Rationality" by Wheeler, Gregory, The Stanford Encyclopedia of Philosophy (Fall 2020 Edition), Edward N. Zalta (ed.), URL = < https://plato.stanford.edu/archives/fall2020/entries/bounded-rationality/ >

[3] Article from Wikipedia, "Bounded Rationality", Link: https://en.wikipedia.org/wiki/Bounded_rationality Last Seen: 05.09.2021

unimaginable for the corporation, a state of stagnation is real and it incurs irreparable financial or other kinds of damages.

At the first steps of establishing new corporation the shareholders rarely anticipate about future conflicts. They set a standard charters and other corporate documents since not properly appreciating legal formalities – thinking that it is a waste of time and money. Poorly drafted charters lack mechanisms of avoiding and breaking corporate deadlocks. Shareholders at the beginning have huge trust for each other, overoptimism and know a little about each other's real abilities and compatibility. Poor planning leads corporation to conflicts, hence, "the Shareholder conflicts are said to be the Achilles heel of close corporations."[4]

The Supreme Court of Georgia in one of its decisions stated the following: "Corporate legal regulations are one of the basis for maintaining the prosperity and stability of the modern economy."[5] The new law on Entrepreneurs [6] will certainly achieve fundamental changes in the Georgian corporate legislation and change the legal reality in Georgia. Harmonization with the EU legislation, as well as to share elements of USA case law is crucial for developing countries such as Georgia. Refinement of corporate law regulations is one of the main prerequisites for inflow of investments into the country, as "For an investor who intends to make investments money in a particular enterprise / business area, it is essential to which rules verifies the legitimacy of choices made by collegial bodies and directors, in different words, whether disputes arise during the process of corporate governance are subject to judicial control or not." [7]

The exigency of reviewing the present problem was conditioned, on the one hand, by the superficial settlement of this issue by the current legislation of Georgia and, on the other hand,

[4]"Shareholder conflicts in close corporations: between theory and practice. Evidence from Italian private limited liability companies." By PETER AGSTNER, 2018, p.1

[5] Decision of Supreme Court of Georgia, case №ას-324- 2021, 29 June, 2021

[6] See here: https://matsne.gov.ge/ka/document/view/5230186?publication=0 Last Seen: 05.09.2021

[7] "Business disputes and court practice", research is prepared by Ilona Gagua, Supreme Court of Georgia, Chamber of Civil Cases; Tbilisi, 2017, p. 9

by the lack of explications in terms of case law. Obviously, "Judicial practice is of great importance in resolving key issues of corporate law, meaning precisely those aspects of law where the burden of legal regulation falls on the court due to the scarcity of regulatory acts."[8]

Given the scarce legislative framework, it is significant to understand law and share best-case law practices of developed countries.

2.The main characteristics of the close corporations

"A corporation... is a mere conception of the legislative mind. It exists only on a paper through the command of the legislature that its mental conception shall be clothed with power."[9] Corporations are divided into two large groups: Closely held corporations and public (open) corporations. The author's interest sphere particularly is close corporations (prototype is limited liability company known as GMBH in Germany, Société à responsabilité limitée in France, private limited company in England) since deadlocks are more likely to happen in such small and closely held companies ("The distinguishing features of close corporation make them particularly vulnerable to deadlock"[10]). Close corporations are compared with "spiral staircase, hard to describe but recognizable when you see one."[11] The first association which come to one's mind related to close corporation is that "where management and ownership are substantially identical to the extent that the independent judgment of directors is, in fact, a fiction."[12]

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[8] Id. p.9

[9] Vann, J. in People v. Knapp, 201 N.Y. 373, 381, 99 N.E. 841, 844 (1912), In article: Israels, Carlos L. (1952) "The Sacred Cow of Corporate Existence: Problems of Deadlock and Dissolution," University of Chicago Law Review: Vol. 19: Iss. 4, Article 9. p.1

[10] G. L. c. 156D, § 14.30, 25A Mass. Gen.Laws Ann. at 121, In: GEORGE T. KOSHY vs. ANUPAM SACHDEV. SJC-12222. SUPREME JUDICIAL COURT OF MASSACHUSETTS, 477 Mass. 759; 2017; Link: http://masscases.com/cases/sjc/477/477mass759.html, Last Seen: 05.09.2021

[11]Kessler RA (1967), "With Limited Liability for All: Why Not a Partnership Corporation", Fordham L. Rev. 36: p.255. In article "Shareholder conflicts in close corporations: between theory and practice. Evidence from Italian private limited liability companies." By PETER AGSTNER, 2018, p.1

[12] The Validity of Stockholders' Voting Agreements in Illinois, 3 Univ. Chi. L. Rev. 640, 647 (1936). A similar definition was adopted by the New York State Law Revision Commission, N.Y. Leg. Doc. No. 65 K (1948) pp. 3

Close corporation are frequently small, family businesses, due to that the conflict between shareholders or/and directors is even more devastating. Relationships between the people are changeable, due to the several reasons, among them are personality differences or contradictory vision of the company's future development strategy. According to the observations of courts and commentators "the deterioration of relationships among corporate participants may simply be the inevitable result of human nature."[13]

Main difference between closed and public companies is that in close corporation they "do not have separation of functions - the shareholders of a close corporation often serve as the directors or officers, providing the capital and managing the corporation."[14] Shareholders (especially minority shareholders) in close corporation are more vulnerable than shareholders in public companies, because they sometimes invest all their living, while public corporation shareholders invest just the part of their funds. Furthermore, close corporation shareholders have complicatedness with disposing their shares. This problem may be derived from both the shareholders' agreements and the legislation itself. As a result, we get a shareholder who cannot sell the share, cannot manage ("freeze-out") it and cannot receive dividends from the foregoing share.[15]

A classical case which determines close corporation main features is judged by Supreme Judicial Court of Massachusetts Donahue v. Rodd Electrotype Co. This ruling distinguishes 4 main elements of close corporation: "(a) small number of shareholders, usually no more than five;

89 et seq. In article Israels, Carlos L. (1952) "The Sacred Cow of Corporate Existence: Problems of Deadlock and Dissolution," University of Chicago Law Review: Vol. 19: Iss. 4, Article 9. P.2

[13] Susanna M. Kim, "The Provisional Director Remedy for Corporate Deadlock: A Proposed Model Statute, 60 Wash. & Lee L. Rev. 111 (2003), p. 113; Link: https://scholarlycommons.law.wlu.edu/wlulr/vol60/iss1/4

[14] E.g., CHARLES R.T. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS 453 (3d ed. 1999); Easterbrook & Fischel, supra note 9, at 273–77; William S. Hochstetler & Mark D. Svejda, Statutory Needs of Close Corporations—An Empirical Study: Special Close Corporation Legislation or Flexible General Corporation Law? 10 J. CORP. L. 849, 853–56 (1985). In article Shannon Wells Stevenson, The Venture Capital Solution to the Problem of Close Corporation Shareholder Fiduciary Duties, 51 Duke Law Journal, 2001, p. 1142.

[15] Shannon Wells Stevenson, The Venture Capital Solution to the Problem of Close Corporation Shareholder Fiduciary Duties, 51 Duke Law Journal, 2001, p. 1143-1144.

(b) strong shareholder participation in the management of the corporation; (c) no ready market for shares; and (d) share transfer restrictions. These key elements contribute to the understanding of a close corporation as an "incorporated partnership" with strong proprietary foundations."[16]

English case law offers determination of quasi – partnerships in case Ebrahimi v Westbourne Galleries Ltd ((1973) AC 360, 379), hence the following elements are to define private company: "(1.) an association formed or continued on the basis of a personal relationship, involving mutual confidence - this element will often be found where a pre-existing partnership has been converted into a limited company; (2.) an agreement, or understanding, that all, or some (for there may be "sleeping" members), of the shareholders shall participate in the conduct of the business; (3.) restriction upon the transfer of the members' interest in the company - so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere".[17]

3. A classical concept of corporation deadlock

Deadlock is an impasse in decision making processes of corporation caused by irreconcilable differences between shareholders and/or directors. It is defined as "a decision or indecision of stockholders, which results in the corporation's inability to perform its corporate powers … (or) a state of inaction or neutralization caused by the opposition of persons or of factions."[18]

Deadlocks can be related to several types of decision-making failure, particularly: "1). The failure of equal members or managers to reach agreement; 2). The failure to obtain a required

[16] Ribstein LE (2010), The Rise of the Uncorporation, Oxford University Press, Oxford. P.96; Armour J, Whincop MJ (2001), An Economic Analysis of Shared Property in Partnership and Close Corporations Law, J. Corp. L. 26. p.985, In article: "Shareholder conflicts in close corporations: between theory and practice. Evidence from Italian private limited liability companies." By PETER AGSTNER, 2018, p.3

[17] 328 N.E.2d 505, 511 (Mass. 1975), In article: "Shareholder conflicts in close corporations: between theory and practice. Evidence from Italian private limited liability companies." By PETER AGSTNER, 2018, p.3;

[18] Hendley v. Lee, 676 F. Supp. 1317, 1323 (D.S.C. 1987) (quoting Callier v. Callier, 378 N.E.2d 405,408 (Ill. App. Ct. 1978) In article: Susanna M. Kim, "The Provisional Director Remedy for Corporate Deadlock: A Proposed Model Statute, 60 Wash. & Lee L. Rev. 111 (2003), p. 112;

majority vote; 3). The failure to obtain a required approval from a member with approval rights; and 4). The failure to obtain unanimous consent where unanimity is required.''[19]

Generally, deadlock exists in two forms: 1). Shareholder and 2). Director deadlocks. Classical definition of shareholder deadlocks is: "when the shareholders are so divided that they have not been able, for two consecutive meetings, to elect successors to directors whose terms have expired if successors had been elected and qualified.''[20] Director deadlock definition is the following: "The director or other person having management authority are unable to effect action on one or more substantial matters respectively the management of the company's business.''[21]

By general understanding corporate deadlock is a state of corporate paralysis, when advancement of a company is suspended and there does not seem to be any prospect on the horizon for the two opposing sides (having an equal controlling stake) to come to agreement. Despite the fact that dissolution verdict has been used many times by the courts on the basis of deadlock, before the case of Koshy v Sachdev there was no definition of "true deadlock". Supreme court of Massachusetts had a "first effort to construe that state's deadlock-dissolution statute, devised a four-factor test to determine a "true deadlock'' exists.''[22] Determining true meaning of corporate deadlock is crucial as far as "involuntary dissolution should be available as a mechanism for resolving internal corporate disputes only in the case of true deadlock, and even then, only when continuation of the deadlock will impose real and serious harm.''[23]

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[19] Louis T. M. Conti, Lisa R. Jacobs, Steven N. Leitess , "Deadlock-Breaking Mechanisms in LLCs—Flipping a Coin Is Not Good Enough, but Is Better Than Dissolution." Business Law Today, March 23, 2017; https://www.americanbar.org/groups/business_law/publications/blt/2017/03/03_conti/ Last Seen: 05.09.2021

[20] N.J.S.A. 14(a):12-7(1), In article: "Corporate Deadlock – When Shareholders Seek the Courts' Assistance in Forcing Buy-outs"." June 28, 2017, by David R. Pierce. Link: https://www.lindabury.com/firm/insights/corporate-deadlock-shareholders-seek-courts-assistance-forcing-buy-outs.html Last Seen: 05.09.2021

[21] Id.

[22]"Court Defines "True Deadlock."; By Peter Mahler on October 9,2017; Link: https://www.nybusinessdivorce.com/2017/10/articles/deadlock/court-defines-true-deadlock/ Last Seen: 05.09.2021

[23] Mark D. Finsterwald, "The Supreme Judicial Court Explains Statutory Criteria for Dissolution of a Corporation Due to Director Deadlock", case comment, Koshy v. Sachdev, 477 Mass. 759 (2017); Massachusetts Law Review

George T. Koshy and Anupam Sachdev were the 50/50 shareholders and directors of Indus Systems, Inc. (Indus) which was established in 1987. The Company was provider of web-based facilities information systems. After 2000s, the relationship between the partners went to rack and ruin due to the contradicting views of the company's strategic business direction. The first claim was brought by Sachdev about the huge distribution which was taken without Sachdev's consent. [24] Based on Corporate dissolution statutes, in 2012, Koshy brought a suit and claimed dissolution (based on Massachusetts General laws ch. 156D, § 14.30) of Indus pursuant to deadlock, together with breaking of fiduciary duty by Sachdev who counterclaimed itself. Koshy's claims were dismissed by judge, afterwards the case was transferred to Supreme court of Massachusetts.

According to SJC dissolution is admissible remedy in case of "true deadlock", which itself implies three statutory criteria to be met.[21] The criteria are the following: "(1) the existence of a deadlock; (2) inability of the shareholders to break the deadlock; and (3) irreparable injury to the corporation."[25] Burden of proof of foregoing criteria lies to the petitioning party.

A "four-factor test" was formed by the court, hence a statutory definition of deadlock does not exist. Those factors are: 1). Whether "irreconcilable differences between the directors have resulted in "corporate paralysis," which the court defined as "a stalemate between the directors concerning one of the primary functions of management." (Quoting from a 1966 decision by Maine's Supreme Court).[26] 2). The size of the corporation. The court explained that "(a) deadlock is more likely to occur in a small or closely-held corporation, particularly one where ownership is divided on an even basis between two shareholder-directors."[27] In a such

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Volume 99, No. 3 Published by the Massachusetts Bar Association, May, 2018, p.69; Link: https://foleyhoag.com/-/media/files/foley%20hoag/publications/articles/2018/mlrvol99no3.ashx , Last Seen: 05.09.2021

[24] Id. p.70

[25] Id. p.70

[26]"Court Defines "True Deadlock."; By Peter Mahler On October 9,2017; Link: https://www.nybusinessdivorce.com/2017/10/articles/deadlock/court-defines-true-deadlock/ Last Seen: 05.09.2021

[27] Mark D. Finsterwald, "The Supreme Judicial Court Explains Statutory Criteria for Dissolution of a Corporation Due to Director Deadlock", case comment, Koshy v. Sachdev, 477 Mass. 759 (2017); Massachusetts Law Review

corporation the shareholder's stock is lack of a ready market "and the greater likelihood that a shareholder is reliant on the corporation for a salary, tends to increase the potential for deadlock and accompanying oppressive tactics"[28] 3) Whether there is any indication that a party has "manufactured a dispute" to create a deadlock in which situation "a court should view the party's claim with skepticism".[29] 4) The degree and extent of distrust and antipathy between the directors" where "mutual antipathy can transform what may begin as a run of the mall disagreement into irreconcilable conflicts and stalemate where hostility precludes compromise."[30]

In regard to applying foregoing "4 factor test", SJC determined the following: 1. Considering the fact, that the parties only agreed on employee raises and hiring a new salesperson, "The parties are diametrically opposed to nearly every issue of importance concerning Indus's current operations and its future."[31] 2. As the parties are 50/50 percent owners and directors of Indus, the second criteria are satisfied. 3. As the facts obviously show hostile attitude of the parties in regard to core elements of corporate governance, there is not a place for skepticism whether either party manufactured deadlock. 4. Given that Koshy "views all of Sachdev's actions as an attempt to freeze him out of the management of the company" and that "Sachdev questions all of Koshy's actions." The record is replete with personal insults, questioning of motives, and general acrimony between the parties. This mutual antipathy in a two-director corporation has prevented the parties from compromising and has inspired increasing levels of

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Volume 99, No. 3 Published by the Massachusetts Bar Association, May, 2018, p.70; Link: https://foleyhoag.com/-/media/files/foley%20hoag/publications/articles/2018/mlrvol99no3.ashx Last Seen: 05.09.2021

[28] "Court Defines "True Deadlock,"; By Peter Mahler On October 9, 2017; Link: https://www.nybusinessdivorce.com/2017/10/articles/deadlock/court-defines-true-deadlock/, Last Seen: 05.09.2021

[29] Id.

[30] Id.

[31] "Court Defines "True Deadlock,"; By Peter Mahler On October 9, 2017; Link: https://www.nybusinessdivorce.com/2017/10/articles/deadlock/court-defines-true-deadlock/, Last Seen: 05.09.2021

brinksmanship. Accordingly, we conclude that Koshy has met his burden to show that the parties are deadlocked within the meaning of § 14.30 (2) (I)." [32]

More than 5 years of litigation process, after several lawsuits the SJC concluded that "the deadlock existed, the shareholders could not break it, and the corporation was suffering or under a threat of irreparable injury."[33] After determining the deadlock was existed SJC submitted the case to the Superior court for defining whether dissolution would be the relevant remedy.[34] For breaking a deadlock, in this situation "buy-sell agreements'' and "agreements for alternative dispute resolution'' was mentioned by court, but none of them suited this case due to the incorporation agreement article which provided buyout at a price determined by panel of arbitrators.[35] Due to the circumstance, that above-mentioned provision "requires agreement upon an arbitrator"[36] the court held that shareholders could not break the deadlock.[37]

4. Manufactured deadlocks and bad faith defense as a "Gordian Knot" of the corporate law

Granting certain types of rights to legal entities carries the risk that they will abuse those rights in bad faith. Since the meaning of corporate deadlock has already been explained above, it is also necessary to pay attention to the artificially created deadlock identifying prerequisites through case law analysis.

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[32] Mark D. Finsterwald, "The Supreme Judicial Court Explains Statutory Criteria for Dissolution of a Corporation Due to Director Deadlock", case comment, Koshy v. Sachdev, 477 Mass. 759 (2017); Massachusetts Law Review Volume 99, No. 3 Published by the Massachusetts Bar Association, May, 2018, p.69; Link: https://foleyhoag.com/-/media/files/foley%20hoag/publications/articles/2018/mlrvol99no3.ashx Last Seen: 05.09.2021

[33] Id. 69

[34] Id. 70

[35] Id.71

[36] GEORGE T. KOSHY vs. ANUPAM SACHDEV. 477 Mass. 759, May 2, 2017 - September 14, 2017 Link: http://masscases.com/cases/sjc/477/477mass759.html Last Seen: 05.09.2021

[37] Mark D. Finsterwald, "The Supreme Judicial Court Explains Statutory Criteria for Dissolution of a Corporation Due to Director Deadlock", case comment, Koshy v. Sachdev, 477 Mass. 759 (2017); Massachusetts Law Review Volume 99, No. 3 Published by the Massachusetts Bar Association, May, 2018, p.69; Link: https://foleyhoag.com/-/media/files/foley%20hoag/publications/articles/2018/mlrvol99no3.ashx Last Seen: 05.09.2021

Shawe v. Elting is outstanding case which attracted the public attention due to it was the first time "the Delaware Chancery Court ordered the sale of a profitable company against the wishes of a 50% owner."[38] Shawe assessed the decision, as "a government takeover of this company." [39]

Phil Shawe and Liz Elting were ex-fiancées for each other, who started their business in a college, are founding co-owners TransPerfect Global, Inc., "a hugely successful international translation and business services company established under Delaware law and headquartered in New York City, with 2014 revenues approaching $500 million, net income of almost $80 million, and no debt."[40]

This is an unprecedented decision and it is of particular importance to Delaware, as Citizens for Pro-Business Delaware, the group made up of TransPerfect workers, argue that Delaware's reputation as "the gold standard" for corporate law, a franchise that puts more than $ 1.3 billion in the state's coffers every year, was at stake.[41] Elting was seeking a custodian under title 8, Section 226(a)(2) of the Delaware General Corporation Law "to resolve board-level deadlock by selling the Company (Count I) and dissolution of the Company under the Court's equitable powers (Count II)."[42]

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[38] Brian C. Durkin, Manufactured Deadlocks? The Problematic "Bad Faith Defense" to Forced-Sales of Delaware Corporations Under Section 226 of the Delaware General Corporation Law, 59 B.C. L. Rev. 725 (2018), p. 725 Link: https://lawdigitalcommons.bc.edu/bclr/vol59/iss2/6, Last Seen: 05.09.2021

[39] Karl Baker, The News Journal, updated 21 Nov., 2017. "Delaware may finally be done with TransPerfect feud"; Link: https://www.delawareonline.com/story/money/business/2017/11/21/delaware-may-finally-done-transperfect-feud/884363001/ , Last Seen: 05.09.2021

[40] Peter Mahler, "Locked In Corporate Hell": Bitter Feud Between Deadlocked 50/50 Owners Leads Court To Order Sale Of Lucrative Company." 17 August, 2015, Farrell Fritz, P.C., Link: https://www.nybusinessdivorce.com/2015/08/articles/deadlock/locked-in-corporate-hell-bitter-feud-between-deadlocked-5050-owners-leads-court-to-order-sale-of-lucrative-company/ Last Seen: 05.09.2021;

[41] Jeff Mordock, The News Journal, updated On Sep.23, 2016; "TransPerfect employees attack Delaware law"; Link: https://www.delawareonline.com/story/news/2016/08/05/attack-delawares-chancery-law/87938228/ Last Seen: 05.09.2021

[42] Memorandum Opinion, PHILIP R. SHAWE, derivatively on behalf of TRANSPERFECT GLOBAL, INC., and in his individual capacity v. ELIZABETH ELTING; IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE; p.66. Link: https://www.nybusinessdivorce.com/wp-content/uploads/sites/94/2015/08/Shawe-Opinion.pdf, Last Seen: 05.09.2021

Title 8, Section 226 of the Delaware General Corporation Law Section 226, which has no analog in New York's Business Corporation Law,[43] ("Section 226") grants courts, in exceptional cases, to intervene in the affairs of corporations, with the aim of breaking deadlocks and preventing irreversible harm for those companies.[44] Section 226 allows the Chancery Court to appoint a receiver or custodian for a corporation when "(1) the "stockholders are so divided" that they cannot elect directors; (2) the directors are in such a state of deadlock that they are unable to make managerial decisions and the corporation is thus faced with "irreparable" harm; or (3) when the corporation has "abandoned its business" purpose and failed to adequately dissolve itself."[45] The Chancery Court is also granted with a discretion to decide extent of authority to give the appointed custodian or receiver, to appoint a custodian to take measures as a "tie breaking" director with a goal to resolve deadlocks between directors, to allow the appointed custodian the authority to sell an insolvent corporation for shield the business from causing extra obligations and causing assist budgetary harm.[46] TransPerfect was an exceptional case in Delaware history as the Section 226 was used for appointing a custodian to sell a profitable company. Chancellor Bouchard states: "although it is true that the Company is and has been a profitable enterprise to date, its governance structure is irretrievably dysfunctional. The Company already has suffered from this dysfunction and, in my view, is threatened with much more grievous harm to its long-term prospects if the dysfunction is not addressed."[47]

[43] Peter Mahler, "Locked In Corporate Hell": Bitter Feud Between Deadlocked 50/50 Owners Leads Court To Order Sale Of Lucrative Company." 17 August, 2015, Farrell Fritz, P.C., Link: https://www.nybusinessdivorce.com/2015/08/articles/deadlock/locked-in-corporate-hell-bitter-feud-between-deadlocked-5050-owners-leads-court-to-order-sale-of-lucrative-company/ Last Seen: 05.09.2021;

[44] Brian C. Durkin, Manufactured Deadlocks? The Problematic "Bad Faith Defense" to Forced-Sales of Delaware Corporations Under Section 226 of the Delaware General Corporation Law, 59 B.C. L. Rev. 727 (2018), p. 727 Link: https://lawdigitalcommons.bc.edu/bclr/vol59/iss2/6, Last Seen: 05.09.2021

[45] Id. p.727

[46] Id. p.727

[47] Peter Mahler, "Locked In Corporate Hell": Bitter Feud Between Deadlocked 50/50 Owners Leads Court To Order Sale Of Lucrative Company." 17 August, 2015, Farrell Fritz, P.C., Link: https://www.nybusinessdivorce.com/2015/08/articles/deadlock/locked-in-corporate-hell-bitter-feud-between-deadlocked-5050-owners-leads-court-to-order-sale-of-lucrative-company/ Last Seen: 05.09.2021;

According to the critics of Chancellor Bouchard 's ruling, selling the TransPerfect represents "judicial overreach"[48] and "sets dangerous president for the laws governing corporations in Delaware, especially considering the state's reputation as a business-friendly locale.''[49]

Shawe v. Elting case is significant for another reason, by rejecting Shawe's claim, that Elting has manufactured the deadlock to open the door a sale of the Company, the "court implicitly acknowledged that such claims, if substantiated by the facts, could constitute a valid defense in future cases".[50] Although the court has not established any definite standard for determining a genuinely and artificially created deadlock, one thing is for sure, based on this decision, "an allegation that an owner/director acted in bad faith to manufacture a deadlock constitutes a valid defense to a Section 266 action."[51]

One more case, where "bad faith defense'' was the subject at discussion is - Feinberg v. Silverberg (2013), this time Supreme court of New York under Section 1104 of New York's Business Corporation law, had to decide "whether or not the alleged bad faith of a petitioner seeking dissolution is even relevant."[52]

In Feinberg v. Silverberg the court cites Gorden & Weiss case: "(T)he underlying reason for the dissension is of no moment, nor is it relevant to ascribe fault to either party. Rather, the critical consideration is the fact that dissension exists and has resulted in a deadlock precluding

[48] Jeff Mordock, The News Journal, updated On Sep.23, 2016; "TransPerfect employees attack Delaware law"; Link: https://www.delawareonline.com/story/news/2016/08/05/attack-delawares-chancery-law/87938228/ Last Seen: 05.09.2021

[49] Brian C. Durkin, Manufactured Deadlocks? The Problematic "Bad Faith Defense" to Forced-Sales of Delaware Corporations Under Section 226 of the Delaware General Corporation Law, 59 B.C. L. Rev. 727 (2018), p. 725 Link: https://lawdigitalcommons.bc.edu/bclr/vol59/iss2/6, Last Seen: 05.09.2021

[50] Id. p.750

[51] Id. p. 749

[52] Feinberg, Index No. 3120-11, at *2, *4–6, *8 (citing in re Goodman v. Lovett, 200 A.D.2d 670, 670–71 (N.Y. App. Div. 1994) In article: Brian C. Durkin, Manufactured Deadlocks? The Problematic "Bad Faith Defense" to Forced-Sales of Delaware Corporations Under Section 226 of the Delaware General Corporation Law, 59 B.C. L. Rev. 727 (2018), p. 743 Link: https://lawdigitalcommons.bc.edu/bclr/vol59/iss2/6, Last Seen: 05.09.2021

the successful and profitable conduct of the corporation's affairs."[53] The foregoing case allow us to conclude that even if an applicant spitefully provoked deadlock with the specific intention to create corporate deadlock, nevertheless "through manufactured, is still a deadlock."[54]

In Feinberg v. Silverberg case, the court has suggested a different approach that the 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,"[55] accordingly orders that the court "will permit evidence at the hearing related to Silverberg's purported bad faith in creating dissension and deadlock…"[56]

Although there are a different and ambiguous opinions between the courts on the admissibility of "bad faith defense" Vila v. BVWebTies LLC case represents helpful standard to distinguish "bona fide" and ''manufactured deadlocks": "Circumstantial evidence of intent, . . . design and timing, (and the petitioner's) credibility."[57] Which implies itself that prior to the initiation of the case in court, the party requesting the dissolution of the enterprise on the grounds of deadlock did everything at his power to prevent it, and there are proving factual evidences of it in the case.[58]

While there are compelling arguments on both sides, the author shares the view put forward by the court in Feinberg v. Silverberg case. Neither the law nor the court should allow either

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[53] Peter Mahler, "Is Bad Faith a Defense in Deadlock Dissolution Proceedings?", on September 16, 2013, Farrell Fritz, P.C. Link: https://www.nybusinessdivorce.com/2013/09/articles/deadlock/is-bad-faith-a-defense-to-deadlock-dissolution-petition/ Last Seen: 05.09.2021

[54] Brian C. Durkin, Manufactured Deadlocks? The Problematic "Bad Faith Defense" to Forced-Sales of Delaware Corporations Under Section 226 of the Delaware General Corporation Law, 59 B.C. L. Rev. 727 (2018), p. 744 Link: https://lawdigitalcommons.bc.edu/bclr/vol59/iss2/6, Last Seen: 05.09.2021

[55] Peter Mahler, "Is Bad Faith a Defense in Deadlock Dissolution Proceedings?", on September 16, 2013, Farrell Fritz, P.C. Link: https://www.nybusinessdivorce.com/2013/09/articles/deadlock/is-bad-faith-a-defense-to-deadlock-dissolution-petition/ Last Seen: 05.09.2021

[56] Id.

[57] Wilford, Case No. 15-856-BC, at *6 (citing Vila, 2010 WL 3866098, at *8).; In article: Brian C. Durkin, Manufactured Deadlocks? The Problematic "Bad Faith Defense" to Forced-Sales of Delaware Corporations Under Section 226 of the Delaware General Corporation Law, 59 B.C. L. Rev. 727 (2018), p. 748 Link: https://lawdigitalcommons.bc.edu/bclr/vol59/iss2/6, Last Seen: 05.09.2021

[58] Id. p. 748

party to act in bad faith and use the right only to harm the others. The courts must be very careful about the separation of real and artificially created deadlock, so as not to establish a vicious practice in the market, which will ultimately lead to a gross violation of the interests of bona fide shareholders.

5. Available mechanisms for breaking corporate deadlock

In close corporations' co-venturers are free to drawn up an operating agreement as it is needed for them, according to Delaware Limited Liability Company Act C. § 18-1101(b): Delaware law will "give maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements."[59] Freedom of contract means freedom of choosing deadlock avoidance mechanisms. Among variety of deadlock avoidance mechanisms, most common are: External or Internal "Tie-Breakers", Buy-Sell Provisions, Put or Call mechanisms, partition or sale of the company or its assets and etc.[60] Although, the partners may ex ante determine deadlock-breaking mechanisms, the court may order dissolution according to the "not reasonably practicable standard".[61] Hereinafter we will focus on two of the most common mechanism.

A tie-breakers, may be internal or external industry experts, mediators, arbitrators, or professional advisors[62], who may be called in case of management deadlock. A tie-breaker may be internal (the board chairperson) or independent third party.[63] The negative aspect of this mechanism is the following "the decision is removed from the parties most familiar with the

[59] Delaware Limited Liability Company Act, Link: https://delcode.delaware.gov/title6/c018/sc11/index.html, Last Seen: 05.09.2021

[60] Louis T. M. Conti, Lisa R. Jacobs, Steven N. Leitess , "Deadlock-Breaking Mechanisms in LLCs—Flipping a Coin Is Not Good Enough, but Is Better Than Dissolution." Business Law Today, March 23, 2017;. https://www.americanbar.org/groups/business_law/publications/blt/2017/03/03_conti/ Last Seen: 05.09.2021

[61] Id.

[62] McCabe Rabin, P.A., "Instituting a Deadlock-Breaking Mechanism in Your LLC Operating Agreement", April 11, 2018, Link: https://www.mccaberabin.com/instituting-a-deadlock-breaking-mechanism-in-your-llc-operating-agreement Last Seen: 05.09.2021

[63] Louis T. M. Conti, Lisa R. Jacobs, Steven N. Leitess , "Dissolution and Rational Choice: The Unique Remedial Framework for Director Deadlock Under the Illinois Business Corporation Act", By Kenneth J. Vanko, Northern Illinois University Law Review, Vol. 38-1, p.376

company and its business and put in the hands of third parties who may not have the requisite insight."[64] The outsider may not have enough experience and knowledge to hold a business. One the other side, co-venturers may put internal tie-breakers, which "may call the director to take alternative turns casting the decisive vote."[65] The foregoing mechanism is ineffective when the company have 50/50 percent shareholders, since it may lead the company to "feign deadlock" and enable internal tie-breaker abusing powers granted to him. [66]

Another widespread deadlock avoidance mechanism is Buy-sell provisions. According to this approach, consequently one of the shareholder's interests should be sold. There are two major forms: 1. an "appraisal" model – the interest should be appraised by an expert to assess the value and sell it. 2. a "shotgun" model/ "Russian Roulette"/ "Texas Shoot Out" – allows one shareholder to offer to sell other deadlocked shareholder's interest at a set price and terms, the offeree should agree on the offered price and terms, or sell the offeror's interest with identical provisions. [67]

A "shotgun" provision in Gries v. Plaza Del Rio Mgmt. case is defined by Arizona Court of Appeals: "… 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."[68]

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[64] Louis T. M. Conti, Lisa R. Jacobs, Steven N. Leitess , "Deadlock-Breaking Mechanisms in LLCs—Flipping a Coin Is Not Good Enough, but Is Better Than Dissolution." Business Law Today, March 23, 2017. https://www.americanbar.org/groups/business_law/publications/blt/2017/03/03_conti/ Last Seen: 05.09.2021

[65] "Dissolution and Rational Choice: The Unique Remedial Framework for Director Deadlock Under the Illinois Business Corporation Act", By Kenneth J. Vanko, Northern Illinois University Law Review, Vol. 38-1, p.376

[66] Id. p.376

[67] Louis T. M. Conti, Lisa R. Jacobs, Steven N. Leitess , "Deadlock-Breaking Mechanisms in LLCs—Flipping a Coin Is Not Good Enough, but Is Better Than Dissolution." Business Law Today, March 23, 2017. https://www.americanbar.org/groups/business_law/publications/blt/2017/03/03_conti/ Last Seen: 05.09.2021

[68] Gries v. Plaza Del Rio Mgmt. Corp., 335 P.3d 535-536(Ariz. Ct. App. 2014); In Article: "Dissolution and Rational Choice: The Unique Remedial Framework for Director Deadlock Under the Illinois Business Corporation Act", By Kenneth J. Vanko, Northern Illinois University Law Review, Vol. 38-1, p.376

Advantages of Buy-sell provision are: 1. They ‘‘insure a high degree of fairness with regard to price.”[69] 2. Permits ‘‘quick and clean exit from the company, even where negotiations between the parties have been abandoned”[70]. 3. Forces the parties to obtain ‘‘an amicable settlement.’’[71] 4. Facilitates the continuous operation of the company, stimulating deadlocked parties to act in good faith.[72]

As for the disadvantages of Buy-sell provisions, can be distinguished the predictable result that the partner who decided to quit from the company may be forced to be the only owner of it.[73] In some circumstances, when one party is financially stronger, stronger one may force weaker party to exit from company at an unfair price.[74]

When the shareholders determine contractual mechanisms due to avoid deadlocks, the subject at interest is also whether they are entitled to waive their right to demand judicial dissolution of the company or not. The answer of this question is found in R&R CAPITAL, LLC v. BUCK & DOE RUN VALLEY FARMS, LLC case where The Delaware Court of Chancellery held that: “The waiver is permissible and enforceable because it contravenes neither the Act itself nor the public policy of the state.”[75] It is obvious, that the main value for Delaware Court is contractual freedom. Additionally, the court explains “the legitimate business reasons” why LLC members may wish to waive their right of judicial dissolution: “it is common for lenders to deem in loan agreements with limited liability companies that the filing of a petition for

[69] Fett/Spiering (note 5), § 7 marg. no. 570; Schwarz (note 7), § 20 marg. no. 11; Wälzholz (note 5), 86. In article: “Shoot-Out Clauses in Partnerships and Close Corporations – An Approach from Comparative Law and Economic Theory” by Holger Fleischer and Stephan Schneider, ECFR 1/2012, p. 40

[70] Fett/Spiering (note 5), § 7 marg. no. 570; Schwarz (note 7), § 20 marg. no. 11; Wälzholz (note 5), 86. Id. p.40

[71] Id. p.40

[72] “Dissolution and Rational Choice: The Unique Remedial Framework for Director Deadlock Under the Illinois Business Corporation Act”, By Kenneth J. Vanko, Northern Illinois University Law Review, Vol. 38-1, p.377

[73] “Shoot-Out Clauses in Partnerships and Close Corporations – An Approach from Comparative Law and Economic Theory” by Holger Fleischer and Stephan Schneider, ECFR 1/2012, p.41

[74] Id. p.41

[75] Memorandum Opinion, R&R CAPITAL, LLC and FTP CAPITAL, LLC v. BUCK & DOE RUN VALLEY FARMS, LLC and others, p.21, Link: https://cases.justia.com/delaware/court-of-chancery/110340-0.pdf?ts=1462311571, Last Seen: 05.09.2021

judicial dissolution will constitute a noncurable event of default. In such instances, it is necessary for all members to prospectively agree to waive their rights to judicial dissolution to protect the limited liability company. Otherwise, a disgruntled member could push the limited liability company into default on all of its outstanding loans simply by filing a petition with this Court."[76]

As we saw above, Delaware has a fairly democratic approach in regard to contract-based mechanisms of deadlock avoidance. Given that, "deadlock is not a claim focused on wrongdoing[77]; rather, it is procedural matter impacting corporate governance"[78], hence the author shares Kenneth J. Vanko's opinion that courts should be more supportive of the ways developed by the parties that enables particular ways of breaking deadlock. [79]

6. Remedies

Although there are many different types of remedies (including custodianship or receivers, alternative Dispute Resolution: Mediation and Arbitration, specific performance, voluntary/involuntary dissolution and etc.) None of them are considered to be the unconditionally perfect remedy for breaking Deadlock. The court must assess the circumstances on a case-by-case basis, including the shareholders' "reasonable expectations" as well as deadlock breaking mechanisms, which are reinforced in the company's operating agreement. In some cases, dissolution is really a drastic remedy, but not infrequently it is the best solution not to harm the interests of the party whose shares may be less valued than its fair price, in case of compulsory sellout. In any sense, the court must use any possibility to ensure that the company does not cease to exist or suffer more potential damages.

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[76] Id. P.19

[77] See In re Goodman v. Lovett, 607 N.Y.S.2d 52, 53 (N.Y. App. Div. 1994). In article: "Dissolution and Rational Choice: The Unique Remedial Framework for Director Deadlock Under the Illinois Business Corporation Act", By Kenneth J. Vanko, Northern Illinois University Law Review, Vol. 38-1, p. 378

[78] See 15 PA. CONS. STAT. § 1981(a)(3) (2016); In article: Id.p.378

[79] Id. p. 379

6.1 Provisional Director remedy

When the court decides to interfere in corporation's internal affairs, it may appoint, provisional director. Nevada 2013 revised Statutes allow the court appointing a provisional director in lieu [80] of appointing a custodian or receiver, the established standard is acting in "the best interests of the corporation". Appoint of director does not preclude appointing a custodian or receiver for the corporation.[81] Generally, with some exceptions, provisional director has equal legal power as ordinary director has.[82]

In USA, twenty states have adopted statutes which grants the court to appoint provisional directors[83], hence we can conclude, how important is valued institute is provisional director remedy for common law.

The difference between states is as follows: Some states (e.g., Ohio) allow the appointment of a provisional director only if this is explicitly provided for in articles of incorporation. Some states (e.g., Wisconsin, Montana, Wyoming) give the provisional director powers and responsibilities as ordinary directors, while others (e.g., Delaware, Alaska, California) remove the word "duties", which implies that He does not have the same status that a normal director could have.[84]

There are different opinions related to whether the infringement in shareholders' rights can be justified or not, even when the shareholders did not initially agree on the possibility of an independent third party interfering in corporation affairs.

Issue of liability is also debatable, meaning whether provisional director appointed by the court has fiduciary obligations or not and to what extent.

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[80] In Lieu – Instead.

[81] NV Rev Stat § 78A.140 (2013)

[82] Susanna M. Kim, "The Provisional Director Remedy for Corporate Deadlock: A Proposed Model Statute, 60 Wash. & Lee L. Rev. 111 (2003), p. 115; Link: https://scholarlycommons.law.wlu.edu/wlulr/vol60/iss1/4 . Last Seen: 07.09.2021

[83] Id. p. 114;

[84] Id. p. 116;

6.2 Institute of Custodian and Receiver

The difference between custodian and receiver is that receiver is appointed when the corporation is insolvent,[85] while the custodian may be appointed upon application of any stockholder. According to Delaware General Corporation law, tit. 8 § 226 custodian has all the powers and title of a receiver, but the aim of appointing custodian is to continue the business.[86]

Nevertheless, the receiver is generally being appointed if the corporation is insolvent, there are exceptions, in Hall v. John S. Isaacs & Sons Farms, Inc., the Delaware Supreme Court held that: "Under some circumstances courts of equity will appoint liquidating receivers for solvent corporations, but the power to do so is always exercised with great restraint and only upon a showing of gross mismanagement, positive misconduct by the corporate officers, breach of trust, or extreme circumstances showing imminent danger of great loss to the corporation which, otherwise, cannot be prevented.[87]

Appointment of the custodian forces shareholders to return to a normal relationship in order to quickly resolve dissention and take over the management of the corporation themselves, while giving them an adequate "cooling off period."[88]

The disadvantages of custodian are: as in the case of the provisional director, the management of the company is transferred in the hands of third party, which in turn poses a threat to the company if custodian does not have sufficient experience, knowledge or turn out to be dishonest. The purpose of appointing a custodian is to unstoppably continue the corporation's

[85]Del. Gen. Corp. L., Subchapter 07. Meetings, Elections, Voting and Notice § 226. Link: https://simplifiedcodes.com/?page_id=225 last Seen: 07.09.2021

[86] Id.

[87] Hall, 163 A.2d at 293 (citations omitted). In Article: "Judicial Dissolution: Are the Courts of the State that Brought You in the Only Courts that Can Take You Out?",October 13, 2015, By Peter B. Ladig and Kyle Evans Gay; p. 1062. Link: https://www.morrisjames.com/assets/htmldocuments/TBL%2070-4_04Ladig.pdf ; Last Seen: 07.09.2021.

[88] Note, Deadlock and Dissolution in close corporations, 45 IOWA L. REV. 767, 773 (1960), In article: Susanna M. Kim, "The Provisional Director Remedy for Corporate Deadlock: A Proposed Model Statute, 60 Wash. & Lee L. Rev. 111 (2003), p. 126; Link: https://scholarlycommons.law.wlu.edu/wlulr/vol60/iss1/4 . Last Seen: 07.09.2021

internal processes, rather than to increase its profit, thus it is a temporary remedy.[89] Appointment of a custodian may cause mistrust from third parties' (creditors, suppliers, customers) perspective towards the corporation. Third parties may think that the company is facing financial problems, hence they may demand to fulfill obligations or repay the loan before due date.[90]

6.2 Dissolution

Dissolution is a last resource remedy, when other remedies are inadequate. This remedy originates from common law and "It is not an ordinary claim that can be brought by anyone, anywhere. Just as a state regulates the birth of an entity under its own laws without the interference or participation of its sister states, so too should judicial dissolution be determined by the laws of the state of birth."[91] Dissolution generally is referred to as a "drastic remedy that must not be lightly invoked."[92]

Dissolution can be voluntary or involuntary. Voluntary dissolution is corporation "suicide."[93] The reasons of voluntary dissolution may be permanent loss of the company, company which established with an expiration date, when the operation agreement of the partners states dissolution in case of shareholder's death and etc.[94] The requirement to be met defer from state

[89] Thompson, supra note 1, at 230.; In article: Id. p.126;
[90] See Eileen A. Lindsay, What Can I Do for You? Remedies for Oppressed Shareholders in New Jersey, N.J. LAW. MAG., August 2000, at 37, 39; In Article: Id. p. 126;
[91] 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). In article: "Dissolution and Rational Choice: The Unique Remedial Framework for Director Deadlock Under the Illinois Business Corporation Act", By Kenneth J. Vanko, Northern Illinois University Law Review, Vol. 38-1, p.371
[92] Gidwitz v. Lanzit Cor. Box Co. 170 N.E.2d 131 , 20 Ill. 2d 208 (1960), also Central Standard Life Ins. Co. v. Davis, 10 Ill. 2d 566.) Link: https://law.justia.com/cases/illinois/supreme-court/1960/35627-5.html, Last Seen: 05.09.2021
[93] "Voluntary Dissolution -A New Development in Intercorporate Abuse"; George D. Hornstein; 1941; p. 64. Link: https://core.ac.uk/download/pdf/143656832.pdf , Last Seen: 05.09.2021
[94] "Voluntary Dissolution: Everything You Need to Know", © 2021 UpCounsel Technologies, Inc., Link: https://www.upcounsel.com/voluntary-dissolution, Last Seen: 05.09.2021

to state, it can be based on shareholders' unanimous vote or specified percentages or majority vote (unless otherwise is defined in charter).[95]

In regard to the involuntary dissolution, each state has its own statute that sets out specific criteria for dissolution. According to Delaware Limited Liability Company Act "On application by or for a member or manager the Court of Chancery may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business in conformity with a limited liability company agreement."[96] Not accidentally, the act refers to word "may", which implies that the court is not obliged to "decree dissolution of LLC, but may exercise discretion to do so."[97] The Limited Liability Company Act determines "reasonably practicable" standard, but does not determine its definition.

The "reasonably practicable" standard, usually implies following two cases: "1. Management 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."[98] The burden of proof is on the party seeking dissolution. Every case should be considered individually and the main role have the courts to assess the operating agreement provisions to determine whether it is "reasonably practicable" for the company to carry on business processes. Respectively, based on the given circumstances the court may decide that "even if the entity is not functioning as anticipated or is not profitable, it is still "reasonably practicable" to carry on the business, in which case, dissolution will not be granted."[99]

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[95] "Voluntary Dissolution -A New Development in Intercorporate Abuse"; George D. Hornstein; 1941; p. 65. Link: https://core.ac.uk/download/pdf/143656832.pdf , Last Seen: 05.09.2021

[96] Delaware Limited Liability Company Act, DEL. CODE ANN. tit. 6, § 18-802 (2005); Link: https://delcode.delaware.gov/title6/c018/sc08/index.html , Last Seen: 05.09.2021

[97] Meghan Gruebner, "Delaware's Answer to Management Deadlock in the Limited Liability Company: Judicial Dissolution, 32 J. CORP. L. 641 (2007). p. 643

[98] In the Matter of 1545 Ocean Ave, LLC, 72 AD 3d 121, 131 (NY. App. Div. 2d Dept. 2010) In article: "LLC AND Limited Partnership Dissolution: When Is It "Not Reasonably Practicable to Carry on the Business in Conformity with the [Entity Agreement]"? March 18, 2013; © Samuel Goldman & Associates, Link: http://www.sgalaw.com/news-and-views/2013/3/18/llc-and-limited-partnership-dissolution-when-is-it-not-reaso.html#_ftn1, Last Seen: 05.09.2021

[99] Matter of Extreme Wireless, 299 AD 2d 549, 559 (NY. App. Div. 2d Dept. 2002). In article: Id.

In Decco U.S. Post-Harvest, Inc. v. Mirtech, Inc., C.A. No. 2018-0100-JTL case[100], the court ordered dissolution based on the rationale, that "(T)his court must look to the operating agreement of the LLC to determine the purpose for which it was formed…"[101] "(T)he purpose clause is of primary importance, but other evidence of purpose may be helpful as long as the Court is not asked to engage in speculation."[102] The court found out that the company's stated purpose was to "conduct and coordinate all activities" of the 1-MCP Business[103], the sole product of the company was TruPick and there were no other idea to initiate any other kind of production[104]. The company is prevented to sell its main product, due to it no longer owns intellectual property right, hence the court held that "The evidence establishes that there is no viable 1-MCP Business. It is not reasonably practicable for the Company to carry out this aspect of its business."[105]

A completely different approach from the foregoing case was developed by the Delaware Court of Chancery in the case Meyer Natural Foods LLC v. Duff, 2015 WL 3746283 (Del. Ch. June 4, 2015) the court found, that although LLC's purpose clause is important, nevertheless "LLC's purpose should not, necessarily, be limited to what the LLC agreement identified as the purpose."[106] Specifically, along with the LLC agreement the court examined other contracts of

[100] Memorandum Opinion - Decco U.S. Post-Harvest, Inc. v. Mirtech, Inc., C.A. No. 2018-0100-JTL (Del. Ch. Nov. 28, 2018); Link: https://courts.delaware.gov/Opinions/Download.aspx?id=281570

[101] Arrow, 2009 WL 1101682, at *1 In Memorandum Opinion of Decco U.S. Post-Harvest, Inc. v. Mirtech, Inc., C.A. No. 2018-0100-JTL (Del. Ch. Nov. 28, 2018), p.13; Link: https://courts.delaware.gov/Opinions/Download.aspx?id=281570 .

[102] Meyer, 2015 WL 3746283, at *4, In Memorandum Opinion of Decco U.S. Post-Harvest, Inc. v. Mirtech, Inc., C.A. No. 2018-0100-JTL (Del. Ch. Nov. 28, 2018), p. 13; Link: https://courts.delaware.gov/Opinions/Download.aspx?id=281570 . Last Seen: 05.09.2021

[103] JX 6 § 3.1., In Memorandum Opinion of Decco U.S. Post-Harvest, Inc. v. Mirtech, Inc., C.A. No. 2018-0100-JTL (Del. Ch. Nov. 28, 2018), p. 14; Link: https://courts.delaware.gov/Opinions/Download.aspx?id=281570 . Last Seen: 05.09.2021

[104] § 4.1(d); id. Ex. 4.1(d), In Memorandum Opinion of Decco U.S. Post-Harvest, Inc. v. Mirtech, Inc., C.A. No. 2018-0100-JTL (Del. Ch. Nov. 28, 2018), p. 15; Link: https://courts.delaware.gov/Opinions/Download.aspx?id=281570, Last Seen: 05.09.2021

[105] Id. Memorandum Opinion, p.16

[106] Jason C. Jowers, "Delaware Insider: When Deciding Whether to Judicially Dissolve an LLC, the Court May Find the "Purpose" of the LLC to Be Different Than What Is Stated in the LLC Agreement", December 15, 2015;

the members to find out LLC's true purpose. After examination of LLC agreement, which "limited the company to engage in the PNB Business and related activities"[107] meaning "…marketing, distributing and selling natural Angus beef and beef products under the 'Premium Natural Beef' brand name to the Existing PNB Customers . . ."[108] court also examined output and supply agreement (to supply qualifying cattle)[109] upon which "Meyer had the exclusive right to purchase such cattle. Furthermore, under the purchase agreement by which Meyer acquired its membership interest in PNB, the Duffs and Freeman could not own or operate a business that competed with PNB." The court also found the purpose of the LLC should not be limited by LLC agreement, but also to market and sell beef that had been supplied by PPF and PBF, which did not fulfill, hence it "was no longer reasonably practical for the business to continue" [110] and ordered dissolution.

Dissolution is not an unequivocally negative remedy, furthermore according to the Kansas Court of Appeals, if the dissolution will be removed from profitable but deadlocked company, it "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."[111]

6.3 Other kinds of Remedies

Alternative dispute resolution forms, mediation and arbitration are the kind of remedies where neutral third parties are engaged. In mediation, voluntary dissolution can be achieved by

Business Law Today; Link: https://www.americanbar.org/groups/business_law/publications/blt/2015/12/delaware_insider/

[107] Id.

[108] Id.

[109]Id.

[110] Id.

[111]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). In article: "Dissolution and Rational Choice: The Unique Remedial Framework for Director Deadlock Under the Illinois Business Corporation Act", By Kenneth J. Vanko, Northern Illinois University Law Review, Vol. 38-1, p.362

negotiation, but this remedy is not useful when parties are so antagonistic, that reaching an agreement cannot be imagined. The advantage of mediation is that it does not precludes parties from controlling the corporation. As for the disadvantage, mediation effectiveness is limited and parties may easily breach agreement reached in mediation process.[112]

Arbitration is also alternative dispute resolution form, but in contrast to the mediation, it does not imply a negotiated compromise. [113] The advantage of arbitration is confidential trial, which will definitely end quicker than in state courts. Parties choose the triers themselves experienced in the dispute at issue, finally unlike mediation arbitration decision is enforceable.[114] As for the disadvantage, the arbitrator's decision will be binding even it is not acceptable for the party.

7. Analysis of Georgian case law in regard to the corporate deadlock

The existence of corporate law is immeasurably important for creating a market economy, encouraging trade and inflows of investment. A well-functioning market economy is inconceivable without a well-adjusted legal framework and relevant case law. In the 21st century, when the relations associated to the functioning of entrepreneurial societies are developing on a daily basis and are becoming more complex, it is compulsory for the legislation to take into account the relevant regulations of the existing environment.

The analysis of court cases reveals that from a statistical point of view, the courts consider the cases of medium and large closed companies. In terms of thematic distribution, most of the cases are disputes within the corporation: disagreement between partners and directors or between the partners. Most companies have one or two partners, often with equal shares, and

[112] Susanna M. Kim, "The Provisional Director Remedy for Corporate Deadlock: A Proposed Model Statute", 60 Wash. & Lee L. Rev. 111 (2003), p.131, Link: https://scholarlycommons.law.wlu.edu/wlulr/vol60/iss1/4 last Seen: 05.09.2021

[113] Louis T. M. Conti, Lisa R. Jacobs, Steven N. Leitess , "Deadlock-Breaking Mechanisms in LLCs—Flipping a Coin Is Not Good Enough, but Is Better Than Dissolution." Business Law Today, March 23, 2017; https://www.americanbar.org/groups/business_law/publications/blt/2017/03/03_conti/ Last Seen: 05.09.2021

[114] Id.

in the case of large shareholders, they are the directors of the company themselves. One of the biggest flaws of the current law is that existing forms of closed-type corporations do not offer specific ways to solve existing problems, its general formulations are also a major problem for court practice.[115]

Flaws in the current law become apparent especially once disputes are submitted to the court. During the case law research revealed flaws in the current law, in particular, it is clear that "The law improperly regulates a number of significant issues, which, in turn, negatively affects the quality of court proceedings and the content of decisions made by a judge in corporate litigation. Therefore, it is necessary to eliminate the existing shortcomings and strengthen the role of the legislator in this regard."[116]

In 2008, large-scale amendments were made to the Law on Entrepreneurs of Georgia, aimed at reducing legislative regulations, the law became general in nature, leaving important issues of corporate governance out of regulation. The general norms were intended to give partners freedom of choice, to regulate their relations with each other on the basis of charters and contracts. At first glance, this approach should not have bad results, but in practice the opposite has happened. In former Soviet Union country, where the culture of corporate governance has not been established, overly liberal approaches became the cause of negative consequences. Partners who cannot imagine a future dissension at the starting point of a business, use the simple forms of charters offered by the House of Justice, which ultimately leads to long and costly disputes, along with insufficient regulations under the "Law on Entrepreneurs of Georgia."[117]

[115] "Assessing the impact of regulating the draft law of Georgia on entrepreneurs"; Prepared by aid of GIZ and USAID; Tbilisi, 2018; p.23;
[116] "Explanatory Note on the Draft Law of Georgia on Entrepreneurs", p.2
[117] "Assessing the impact of regulating the draft law of Georgia on entrepreneurs"; Prepared by aid of GIZ and USAID; Tbilisi, 2018; p.15

For a more detailed analysis of the issue raised in this chapter, it is necessary to consider the decisions made by the common courts of Georgia regarding corporate deadlocks. The first case we will consider is the decision of the Supreme Court of Georgia of February 26, 2021, case №ას-285-2019, the subject of dispute was appointment of the director.

The factual circumstances of the lawsuit were as follow: On 5 of June 2002 the plaintiff and the first defendant (M.M.) established LLC "T.E." ("The second defendant") by the decision of the partners, the partner holding the 50% share – "First Defendant" - was appointed as the director of the company (from the moment of the establishment of the company). Since 2012, disagreement has been arisen between the partners, related to the gross violations of the management of company by the partner and the director of the company - M.M., who owns 50% of the shares, to the detriment of the company's interest and for personal gain motive. Among them: financial irregularities that cause material damage to the company, unilateral decision-making by the director on issues to be decided by the partners, prohibition of access to company's documents for the founding partner (SG) holding a 50% share, With the apparent harassment of the 50% shareholder, which manifested itself in the dismissal of the General Manager of his company, which was declared illegal by the Batumi City Court and the plaintiff was reinstated in his position. According to the decision of Batumi City Court of January 9, 2018, within the framework of securing the claim before initiating the lawsuit, his candidacy in the form of D.G.-Dze has been appointed as the authorized director of the company. By the decision of Batumi City Court of July 23, 2018, the lawsuit was rejected. According to the decision of the Chamber of Civil Cases of the Kutaisi Court of Appeal of December 24, 2018, the appeal was rejected, while the appealed decision remained unchanged. The Court of Cassation declared the appeal inadmissible.[118]

The Supreme Court indicated in its reasoning the established uniform case-law and explain the following: "The right of a party to apply to a court for the restoration of a violated right always

[118] Supreme Court of Georgia, case №ას-285-2019

derives from substantive law and it must be based on a specific rule of law unlike the discussion of general civil rights violations, in dealing with an entrepreneurial dispute, the jurisdiction of the court should be separated from each other, to assess the legality of the entrepreneurial decision and the autonomous rights of the enterprise itself.''[119] Further, the court discusses directly on the plaintiff's request to appoint a director by court, on which the court explains that there is no legal basis for satisfying the claim. The Court refers to Article 9^1 (6) (e) of the "Law of Georgia on Entrepreneurs" (hereinafter – "law") and concludes from this Article that "the said issue is not a decision to be taken by the Court but by the General Meeting of Partners of the Company and is characterized by autonomy."[120]

With regard to the deadlock, the court expounded: "It is indisputable that in the first paragraph of Article 46 of the same law (meaning "Law of Georgia on Entrepreneurs") when establishing a company, the partners determined their shares by 50-50%, consequently, they have become the bearers of decision-making risks by themselves and due to disagreements that arose later, they can no longer go to court to seek autonomous decision-making instead of the enterprise.''[121]

Actually, the court left the deadlocked company in a state of disorder, thus indirectly contributed in financial or other kind of damages to the company. The court put forward two arguments in discussion: 1. The right to appoint a director under the substantive law is the exclusive authority of partners' meeting; 2. At the time when the shareholders established the company, the partners should have been assumed that under conditions of equal determination of shares if the dispute would arise between them, they will enter into a corporate deadlock and take the risk themselves.

Certainly, according to the current version of the law, the appointment of the director of the company is a decision to be made by the meeting of partners in a normal situation, however, it

[119] Id.

[120] Id.

[121] Id.

should be noted that the partners are not in a "normal situation", the company is deadlocked and there is no way out. Being in a deadlock harms the company itself, as well as its employees and creditors. The court argument is unreasonable when it refers to the fact that the partners took the risks, while deadlock or the cancellation of the enterprise registration will affect not only the partners themselves, but also the employees of the enterprise, who are expected to lose their jobs in case of an impending financial crisis. Although the current wording of the law does not explicitly derive the court's competence to intervene in decisions made by partners, a deadlock is an exceptional situation and in this situation the court must use all the resources at its disposal to save the enterprise. The deadlock goes beyond for a personal disagreement between the two partners and concerns the interests of other private person (employees, creditors) together with the interests of the state, as the company is a taxpayer involved in the creation of state wealth. Given the fact that most of the companies established in Georgia are closely-held type, in which partners own equal shares, the explanation given by the court may put most companies face with the disappearance from the market.

Furthermore, in decision making process, the court did not take into account either the interests of the enterprise itself or the interests of the aggrieved partner, who had reasonable expectation to gets benefits, while the "Deadlock results in a breakdown in the decisionmaking process and thereby thwarts shareholders' ability to obtain all the benefits of their ownership rights."[122]

Undoubtedly, the main reason for the foregoing explanations by the court is the legislative gap, in particular, the current version of the law does not define either the concept of corporate deadlock, nor its breaking mechanisms.

[122] Susanna M. Kim, "The Provisional Director Remedy for Corporate Deadlock: A Proposed Model Statute", 60 Wash. & Lee L. Rev. 111 (2003), p.120, Link: https://scholarlycommons.law.wlu.edu/wlulr/vol60/iss1/4 last Seen: 05.09.2021

The author believes that the court should have pointed out the gap in the law and therefore should have made a broad definition of the norm and looked at the issue from a global perspective. As already mentioned, the situation between the partners is not a "normal working" process of the company and it should not be subject to the same regulation that applies to normal business processes. It is certain, that the election of a director under the current "Law of Georgia on Entrepreneurs" is the exclusive authority of the partners' meeting, but this regulation should not be applied with a reasonable and fair explanation to the situation when the meeting of partners is in reality dysfunctional, in other words, is unable to exercise the powers vested by law and the charter. According to the author, the situation in the case should be considered as a relationship not provided by law, which is not directly regulated by law and should have been applied Article 5.1 of Civil Code of Georgia ("Analogy of Law and Justice"), which regulates a relationship that is not expressly provided by law, in this case, the legal norm that regulates the most similar circumstance (analogy of law) shall be applied.

Due to the fact that the decision of the partners is considered by the Supreme Court of Georgia as a normal private transaction ("For the purposes of civil law, the decision of the partners is a bilateral / multilateral transaction (Article 50 of Civil Code of Georgia), which must meet all elements of the validity of the transaction as defined by the Civil Code and in case of dispute, the partner who disagrees with the transaction is entitled to protection, by a principle which applies to any infringed or disputed right.")[123] According to the author, The Supreme Court in both of the foregoing cases could rely on two important articles of the Civil Code of Georgia: Article 115, which refers to inadmissibility of abusing rights, precisely exercise right with a sole intention to inflict damages on another person and Article 8.3, which obliges Participants in a legal relationship to exercise their rights and duties in good faith.

The Supreme Court of Georgia in one of its decision states: "The Chamber of Cassation, in order to improve the issue, refers to "The European Convention on Human Rights (ECHR)", Article

[123] Supreme Court of Georgia, Case №ას-1141-2018; 30 November, 2018.

6 of which regulates the right to a fair trial. This provision of the Convention is, in accordance with the case law of the European Court of Human Rights, subject to a broad interpretation and it includes not only an impartial hearing of the case, but also a fair solution, which in itself implies that the administration of justice should not be of a formal nature, but rather that the purpose of the proceedings is focused on the real and effective protection of the violated right, which refers to a comprehensive settlement of the matter by the national court and not to a formal proceeding which cannot result in the elimination of the dispute.''[124]

The decision of the Supreme Court in the case №ას-285-2019 contradicts its own reasoning, which is developed in the case Nას-302-285-2017, due to the decision made in the foregoing case is of a formal nature and does not eliminate the dispute between the partners.

The author does not share the court's argument that the partners should bear the legal consequences arising from the existence of gaps in the law. The parties were inexperienced at the time they had established the enterprise, they could not foresee the expected circumstances, so the argument that at that time they carried all the risks, that the existence of a flaw in the law may give rise to is illogical and unfair reasoning.

One might argue that, in Case №ას-285-2019, the plaintiff could have sued the director for breach of fiduciary obligations (Article 9.6 of "The Law on Entrepreneurs") and could claim dismiss of "director partner", although in this particular case, as well as in other cases, in accordance with the legal precedents established by court, his attempt would end in vain. In the decision of the Kutaisi Court of Appeals of November 26, 2018 (Case #2/ბ-1053-18), the subject of dispute was dismissal of LLC's director, the court states: "According to the relevant evidence, even if the plaintiff actually proves the fact that the director caused damage to the company - the grounds for the dismiss the shareholder from the position of director, the court will not be authorized to assess and discuss the director's challenge / appointment issue in

[124]Supreme Court of Georgia, Case №ას-302-285-2017; 16 June, 2017.

according to the law. As it has already been mentioned, law, as well as the charter of the given company, unequivocally and imperatively stipulates that this is the sole discretion of the meeting of the company's partners."[125] Hereinafter, the court emphasizes on the equal shares of the partners and explains: "Although the 50-50% shareholding of the partners in the company makes it difficult to make the desired decision for a particular party, this cannot be a basis for court intervention in business relations."[126] The Court in this decision describes the situation of the parties as a "deadlock", but characterizes interference in it as "gross interference by the state in private autonomy", which it considers inadmissible due to the following reasoning: "As a rule, courts do not have the institutional ability to evaluate an entrepreneurial decision, as judges generally do not have the necessary knowledge of entrepreneurship and business experience, which is important when evaluating the content of an entrepreneurial decision. For that reason, it is inadmissible for the court to interfere in the competence of the partners' meeting and it is wrong for the court to express its will instead of another partner when the votes are devised."[127]

Interestingly, the Supreme Court discussed an invasion in an autonomous rights of the meeting of partners in one of the cases in which the plaintiff sought the distribution of a dividend. The Court clarifies the following: "According to both the law and the charter of the enterprise, the decision to issue a dividend is at the discretion of the enterprise itself, which implies the discretion in determining the amount of profit to be distributed, and the court must intervene in this decision if there are dishonest actions by authorities, deliberate neglect or abuse of discretion of a partner."[128]

Notwithstanding the above reasoning, the Supreme Court again follows the established practice in the same case (case №ას-1141-2018) and overturns the decision of the Court of

[125] Kutaisi Court of Appeals, Case № 2/ბ-1053-18 (2018-11-26).
[126] Id.
[127] Id.
[128] Supreme Court of Georgia, Case №ას-1141-2018; 30 Novmber, 2018

Appeals on the following grounds: "The court went beyond its own discretion and by making a decision on the distribution of dividends violated the principle of autonomy of the meeting of partners, hence a legally unjustified decision was made."[129] In turn, the Court of Appeals based its decision on an absolutely logical and legal argument: "The company is founded by two partners and both of them have an equal share in the share capital, however, since there is no consensus among the partners, it was possible that the first partner's request for dividend distribution would be rejected."[130] In this regard, the Supreme Court clarifies: "The developed rationale (by the Court of Appeals) may be stated to be characterized by a certain logic, although such a solution of the issue contradicts the substantive principles of corporate law."[131]

The above makes it clear once again, The Supreme Court contradicts its own rationale, on the one hand, by assessing the decision of the Court of Appeals with "certain logic" and, on the other hand, by pointing out that the court, in exceptional cases ("If there are unscrupulous actions by authorized persons deliberate neglect or abuse of discretion of a partner."[132]) has the right to invade the competence of the meeting of partners.

According to Gustav Radbruch, "Law is the will to justice"[133]. The Constitution of Georgia in article 63.1 states: "A judge shall be independent in his/her activity and shall only comply with the Constitution and law." It the norm separates from each other concepts of - "Constitution" and "Law", since "Only the Constitution determines the value of the legal system, the scope of its content. The Constitution is at the top of the positive law hierarchy. At the same time, the Constitution establishes the super positive principles of law, which applies to the entire system of law."[134] Hence the reasoning that "A judge should not follow inhumane laws that contradict

[129] Supreme Court of Georgia, Case №ას-1141-2018; 30 Novmber, 2018
[130] Kutaisi Court of Appeals, Case № 2/ბ-1053-18 (2018-11-26).
[131] Supreme Court of Georgia, Case №ას-1141-2018; 30 November, 2018
[132] Id.
[133] Radbruch G., Five Minutes of legal Philosophy (1945), Oxford Journal of Legal Studies, Vol. 26, No. 1 (2006), pp. 13–15, TRANSLATED BY BONNIE LITSCHEWSKI PAULSON AND STANLEY L. PAULSON, p. 14; Link: https://wystap.pl/wp-content/files/Radbruch_Extreme_Injustice.pdf, Last Seen: 05.09.2021
[134] Khubua G. "Definition of Contra Legem"; Journal "Legal Methods", 2-2018; p. 15; Link: https://sabauni.edu.ge/library/samarTlis-meTodebi.-%E2%84%962.-1600250691.pdf, Last Seen: 05.09.2021

the prevailing views on justice and morality. In special cases, the judge must act against the law and in favor of justice. If a judge carries out an illegal interpretation contra legem[135], he acts within the framework of the Constitution, insofar as he has not violated the principles of law enshrined in the Constitution."[136]

8. Analysis of new law on Entrepreneurs of Georgia in regard to USA and EU law standards

Being part of the Soviet Union negatively impacted on the development of entrepreneurial relations and corporate law in Georgia as a special field of law. Since "Law is not just a social practice, but a normative social practice"[137], Corporate law in Georgia could not have been developed as a result of historical evolution in conditions when the property rights were prohibited in Soviet Union. Respectively, in order to develop a special field of law, it is necessary to create artificial legal norms, which should be properly "adapted to the reality of countries with developed economies."[138]

Lack of corporate legal culture and customs has led to frequent changes in legislation, which "created a feeling of nihilism and distrust in the investor in regard to the law."[139] The law should be adapted to the existing reality. According to the author, Chanturia's opinion on this issue should be shared, which explains the following: "Legislation should bear an "educational" function, to establish norms and regulations for regulating any kind of corporate relationship."[140] Hence, the approach of the state should again go towards the creation of a

[135] Contra Legem – Latin phrase means "contrary to the law". Mary McMahon - "What does "Contra Legem" Mean?", Link: https://www.mylawquestions.com/what-does-contra-legem-mean.htm, Last Seen: 09.09.2021

[136] Id. p.17

[137] Stephen Perry, Hart on Social Rules and the Foundations of Law: Liberating the Internal Point of View, 75 Fordham L. Rev. 1171 (2006). p. 1172; Link: https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=4219&context=flr

[138] "Necroreception in a transformational society (Legal architecture in adjustable, reregulated and deregulated legal system – one the example of post-Soviet Georgia", Center for Law and Economics, Publishing LLC "Sveti", Tbilisi, 2019, p. 9;

[139] Id. 19

[140] See Chanturia, Corporate Governance and the Responsibility of Managers in Corporate Law, 2006, 485., In article: "Necroreception in a transformational society (Legal architecture in adjustable, reregulated and deregulated legal system – one the example of post-Soviet Georgia", Center for Law and Economics, Publishing LLC "Sveti", Tbilisi, 2019, p. 20.

regulated regime, which generally means interference by the state in the market structure or is reflected in the correction of market results."[141]

As already mentioned, on August 2, 2021, the Parliament adopted the law "On Amendments to the Law on Entrepreneurs." Prior to the adoption consultations were held to evaluate its regulation, involving lawyers, business associations, investment companies, government agencies, civil society, etc. The consultations highlighted tremendous flaws of the current law, among them was the unregulated issues related to the exit of a partner from the company.[142]

Critics of the legislation cited negative consequences, including the possibility of abusing the system, as well as the inability of closed corporations to resolve corporate deadlock issues, which in turn was due to non-legislative restrictions in the form of "dispositional rules." According to the respondents, "since the current law does not offer us solutions, such cases, as a result, cause material negative impact on the company's activities, such as, for example, delays in routine business matters, adverse effects on corporate finances, ongoing litigation between shareholders."[143]

Of the changes that have been made to the law, the author discusses and criticizes the articles that deal with the deadlock breaking ways. One of the most important changes in this regard is the determination of the right to voluntary dissolution of the company (Articles 78 and 79 of the law) by the decision of the partners or in the cases provided for in the operating agreement of the partners, and the forced dissolution by a court decision. It should be recognized that the participation of the court is essential based on any foregoing grounds. Thus, the corporation remains no mean to act arbitrarily. To protect property rights, the reasonable expectations of partners and the business interests, it is essential that a court or any other dispute resolution body be involved to balance the interests of the parties.

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[141] Id. p.20;

[142] "Assessing the impact of regulating the draft law of Georgia on entrepreneurs"; Prepared by aid of GIZ and USAID; Tbilisi, 2018; p.15

[143] Id.

The major news is the dissolution of the corporation by the court on the basis of a partner's lawsuit, as defined in Article 79 of the Law. According to the explanatory notes of the law, this regulation serves to resolve the deadlock in the corporation, when the partner grossly violates his duties or the partners can no longer make a decision due to the equal distribution of votes in the society, which ultimately makes it impossible to achieve the society's goal.

Needless to say, the purpose of this norm can not be the dissolution of the corporation, as it is a "drastic remedy". The other partners' interest to extend the existence of the corporation should also be taken into account. Therefore, the law allows other partners to prevent the dissolution of the company by offering to buyout the share at a fair price for the applicant partner.

Article 78 of the Law defines several grounds for dissolution of the company, of which the following two grounds are important in relation to the deadlock:1) Subparagraph "D" of the paragraph 1, which states the decision on the dissolution of the corporation based on the application / lawsuit of the partner; 2) Subparagraph "E" - other grounds provided by the operating agreement.

Significantly positive news is sub-paragraph "E", which shares the USA case law approach and provides for the possibility to dissolute the corporation on the ground ex ante provided in operating agreement. This approach is based on the principle of freedom of contract; hence the agreement of the parties is assessed as the highest value. The foregoing approach is specified in Delaware Chancellery Court's decision in R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC, 2008 WL 3846318 (Del. Ch. Aug. 19, 2008) case as: "For Shakespeare, it may have been the play, but for a Delaware limited liability company, the contract's the thing."[144] This

[144] Jason C. Jowers, "DELAWARE INSIDER: Inadvertently Waiving Right to Seek Judicial Dissolution of LLC: It is Easier to do than You Think", Business Law Today, January 23, 2014. Link: https://www.americanbar.org/groups/business_law/publications/blt/2014/01/delaware_insider/, Last Seen: 09.09.2021

dissolution ground authorizes the parties at their own discretion, to determine in advance, the cases of dissolution of the society, to write in detail what will happen if they find themselves in a deadlock and cannot reach an agreement. This record will make it easier for the courts to make a decision as the agreement of the parties will have the force of law. The referred basis grants the parties with the right to ex ante determine, at their own discretion, the grounds of the dissolution, parties can determine in detail what will happen if deadlock occurs and the agreement cannot be reached. Furthermore, this ground will make it easier for the courts to decide the case due to the agreement of the parties will have a legal force.

The principle of freedom of contract of the parties is also manifested in Article 79, paragraph 5 of the law, which allows the parties to waive the right to seek judicial dissolution of LLC. This right derives from Common law, The Delaware Court of Chancery first referred the waiver of members' right to seek judicial dissolution in R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC, 2008 WL 3846318 (Del. Ch. Aug. 19, 2008) and focused its rationale on freedom of contract. [145] The purpose of the waiver of dissolution right is to prevent the abuse of dissolution rights by partners, which may cause significant harm to the corporation.

The wording of the agreement is important in relation to the waiver, in particular whether it is enough to indicate it only in a simple form or if the parties are to define in detail what the waiver means, in this regard the law is silent, presumably the case law should answer that question.

The American Doctrine recommendation on this subject is: "Likewise, drafters of LLC agreements wishing to preserve members' rights to seek judicial dissolution must do more than simply avoid a specific express waiver. If parties intend to use language limiting members' rights to those expressed in the agreement (as opposed to default rights in the LLC Act where

[145] Id.

the agreement is silent), they should expressly provide the members the right to seek judicial dissolution unless the parties truly intend to waive that right."[146]

The law also silent about what happens after the parties waived judicial dissolution by agreement. It is logical that the parties should determine another remedy acceptable to them (e.g., buyout), however what if they only waived the right of dissolution and did not indicate any alternative remedy? Court practice should answer those questions.

Article 79 of the law grants the partner the right to request a dissolution of the corporation if there is a "substantial ground". A "substantial ground" is determined a deliberate or gross negligent breach of law by one of the partners or breach a substantial duty imposed on him by the operating agreement, or if the partner fails to perform his duty and the goal of the business community is no longer being achieved.

The law does not determine meaning of intentional or gross negligence by the partner, therefore the interpretation of this norm by the court must be tailored to each specific situation. The positive side is that, the parties can determine in advance what they consider as a substantial ground. It is important that the court makes the final decision and it is not up to the partners alone to rule out this issue avoid bad faith defense. It is worth mentioning, that referred article makes it possible to artificially initiate a case, hence the courts will then have to determine the difference between a real and manufactured deadlock and should set a certain standard in regard to it.

As for the disadvantages, the law is silent on a provisional director remedy, custodian or receiver institute, nothing is said about alternative dispute on resolution remedies: mediation and arbitration.

To sum up, changes in law has more advantages than disadvantages and should be estimated positively.

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[146] Id.

9. Conclusion

The objective of the thesis was to define available corporate deadlock breaking mechanism in closely held corporations based on USA statutes and case law analysis, particularly, Delaware Chancellery Court, Supreme Court of New York, Supreme Court of Massachusetts and etc. In regard to the USA corporate law standards was discussed Georgian case law practice and recent changes in "law on Entrepreneurs" of Georgia.

Through analysis of USA case law, the following legal concepts have been explained: General concept of corporate deadlock ("4-factor test"), different approaches in distinguishing of manufactured and real deadlocks and "bad faith" defense characteristics, mechanisms available for avoiding deadlocks (contractual mechanisms, tie-breakers, buy-sell provisions) and remedies (provisional directors, custodian/receiver, compulsory buyout/sellout, arbitration and mediation as a remedy and dissolution). The author tried to illustrate advantages and disadvantages of each deadlock breaking mechanism and remedy. Based on the analysis of the USA court decisions we can come to the conclusion, that none of the deadlock breaking mechanism is an unconditional guarantee that will be shared by the court and dissolution may be avoided if the activities of the company or the actions of the partner are contrary to the law or general principles of law such as - good faith and fair dealing. Also revealed that the dissolution is not always the worst kind of remedy, and in some cases, when the shares are offered less than the real cost price, it might even be justified.

The main recommendation that the author of the thesis has for the start-up entrepreneurs is that to devote time and resources on drafting an LLC operating agrement in accordance with the law and court practice (e.g. to pay attention on revealed purpuses of the corporation), in which they should ex ante determine specific ways to resolve disagreements (e.g. expressly define ways of resolving managment deadlock), the remedial choice is in their hands, concidering that it's logical, fair for every partners and does not opress any partner's interest.

The parties may also agree on the waiver right to judicial dessolution, but in this assence the will of the them must be clearly defined and a lighter remedy must be logically appropriate.

In the following chapters, based on the analysis, revealed that frequent changes in law on Entrepreneurs of Georgia aiming to introduce more liberal norms, on the contrary, have caused negative consequences. The Georgian judiciary faced with the fact that there was no norm in the corporate deadlock that would allow a judge to break the impasse created in the corporation. The analysis of the new law illustrates that the latter is more focused on framing the business, which in turn should be justified in the reality when no corporate culture is established in the country and the jurisprudence cannot avoid the narrow framework of regulation.

Ultimately, the new law should be assessed positively due to it shares United States' experience and standards ("reasonable expectations"; freedom of contracting operating agreement, waiver of dissolution right, right to dissolve corporation based on the grounds established in the operating agreement), which also will be the guarantee that Georgia will fulfil its obligations under the Association Agreement, on the basis of which the ultimate goal is to bring Georgian corporate law closer to international standards. The courts will play a major role in interpreting the new law, as the law does not define certain concepts (e.g., gross negligence of the partner) and its definition is at the discretion of the court in each particular case. The development of corporate law will directly affect the inflow of investment into the country, as in the absence of a legal framework, there will be a risk that investors will not be able to properly protect their capital. The development of a market economy and participation of the country in the international trade relations is beyond the bounds of possibility without the refinement of the norms of corporate law.

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