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New York Business Divorce

Commentary on Dissolution and Other Disputes Among Co-Owners of Closely Held Business Entities

On the Menu: Steak and Equitable Dissolution

By Peter Mahler on April 5, 2021

Fine dining and business divorce crossed paths in a recently decided case featuring a lengthy battle between co-equal ownership factions of the corporation that operates **Delmonico's**, the renowned Manhattan restaurant established in the early 19th century and famous for its signature dish, the Delmonico steak, among other dining firsts.

Delmonico's can now lay claim to another first, though not of the edible kind. Last month, a New York Supreme Court judge of the Manhattan Commercial Division entered final judgment granting "equitable dissolution" of the restaurant corporation known as Ocinomled Ltd. — Delmonico spelled backwards — and ordering the respondent

shareholders who were found to have engaged in oppressive conduct to forfeit their stock holdings.

What is Equitable Dissolution?

The term equitable dissolution can have different meanings in different contexts. In its most generic usage, the emphasis is on the word "equitable," describing generally the judiciary's broad discretion sitting as a court of equity without a jury and where legal remedies (*i.e.*, money damages) are inadequate, to fashion a just resolution of a dispute between business co-owners over the continued existence of the firm.

Equitable dissolution has also taken on more specific meanings. First, it is used to address the court's power to adjudicate a dissolution claim. Two examples come to mind. One is New York's common-law dissolution doctrine as ratified by the Court of Appeals' **1963 ruling in *Leibert v Clapp***, authorizing courts to adjudicate a minority shareholder's non-statutory cause of action for judicial dissolution where the majority shareholders "have so palpably breached the fiduciary duty they owe to the minority shareholders that they are disqualified from exercising the exclusive discretion and the dissolution power given to them by statute."

Another is the **Delaware Chancery Court's 2015 decision in the *Carlisle* case** where Vice Chancellor Laster held that the assignee of an LLC membership interest, who as a non-member lacked standing to seek dissolution under the Delaware LLC Act, nonetheless could seek dissolution under the Chancery Court's common-law authority as a court of equity.

The term has taken on a second, distinct meaning in New York case law, used interchangeably with "equitable buy-out," addressing the court's remedial, common-law authority, upon a finding of grounds for dissolution, to order one side to purchase the other side's interest in the company instead of dissolving it. Take, for example, the Appellate Division's **2004 decision in *Lyons v Salamone*** where, in a statutory dissolution suit brought by a 20% member of an LLC, the court held that it was "an equitable method of liquidation to allow either party to bid the fair market value of the other party's interest in the business, with the receiver directed to accept the highest legitimate bid." Another example is the Appellate Division's **2013 decision in *Mizrahi v Cohen*** where, stating that "in certain circumstances, a buyout may be an appropriate equitable remedy upon the dissolution of an LLC," the court granted the petitioning 50% member's request to compel the other 50% member to sell his interest to the petitioner at a judicially determined value. Notwithstanding that both opinions referred to the buy-out remedy as effectuating a "liquidation" or "dissolution" of the LLC, the buy-out remedy did neither of those things.

Background

In the Delmonico's case, the business relationship between the petitioners — brothers Omer and Ferdo Grgurev — and respondents Milan Licul and Branko Turcinovic began in the 1980s when the four opened their first restaurant venture called Scalatta on Manhattan's Upper West Side. In the late 1990s, they formed Ocinomled to purchase Delmonico's restaurant from the prior operator who had closed the restaurant some years earlier. The Grgurev brothers each owned 25% of Ocinomled as did each of Licul and Turcinovic.

After they renovated the restaurant, Delmonico's became successful and profitable under the day-to-day management of Turcinovic's son. From inception, Licul maintained exclusive control over Delmonico's operations and finances. Licul's long-time accountant handled bookkeeping, financial and tax reporting.

Relations between the owners began to sour around 2012 when Licul and Turcinovic converted one of their other, separately owned restaurants into "Delmonico's Kitchen" and undertook to open a restaurant on Long Island called "Delmonico's of Southampton." The Grgurevs disagreed with the plan for capitalizing other business ventures using the Delmonico's name.

In 2013, the Grgurevs' legal counsel sent Licul and Turcinovic a cease-and-desist letter concerning Delmonico's Kitchen and Delmonico's of Southampton. The letter also demanded access to Ocinomled's books and records. Licul and Turcinovic deflected the request for financial records while seeking to buy out the Grgurevs' shares in the company. The Grgurevs had no interest in selling.

A flurry of litigation followed beginning in 2014, including two books and records proceedings in state court brought by the Grgurevs; a federal court lawsuit by the Grgurevs for trademark infringement and various other direct and derivative claims; a suit by Licul and Turcinovic against the Grgurevs' wives and daughters concerning the Scalatta restaurant; and finally, in 2019, the Grgurevs' dissolution lawsuit.

The Dissolution Petition

In its primary claim for equitable dissolution, the **Grgurevs' Amended Petition** alleged various acts of financial fraud, siphoning of profits, denial of access to company records, and other oppressive conduct by Licul and Turcinovic, for which the Grgurevs sought

> **an order directing equitable, but not legal, dissolution of Ocinomled Ltd., determining the amounts and terms under which Petitioners and/or Ocinomled shall 'buy out' Licul and Turcinovic, or in the alternative, relief under the BCL barring Licul and Turcinovic from serving as directors, requiring repayment of amounts misappropriated by Licul and Turcinovic, and/or judicial dissolution of Ocinomled.**

The Amended Petition also pleaded, but "only as an alternative to equitable dissolution that would keep the Corporation intact and operational," claims for statutory dissolution under Business Corporation Law §§ **1104** and **1104-a** based on alleged shareholder deadlock, internal dissension, and "illegal, fraudulent or oppressive action" by Licul and Turcinovic.

In May 2020, after New York City restaurants closed due to the COVID-19 pandemic, Licul and Turcinovic filed a motion consenting to dissolution based on deadlock under BCL § 1104 and requesting that the court dissolve Ocinomelod, wind up its business affairs, and liquidate its assets. The Grgurevs opposed the motion and filed a cross-motion to appoint a Special Referee to hear and report on issues relating to equitable dissolution. In August 2020, Manhattan Commercial Division Justice Joel M. Cohen entered orders denying the motion to dissolve under BCL § 1104 and granting the cross-motion for appointment of a Special Referee to hear and report.

The Referee's Report

The court-appointed Special Referee, attorney Christopher E. Chang, who was serving double-duty as Temporary Receiver, conducted a three-day virtual hearing in October 2020. He also engaged as neutrals and drew upon the assistance of a forensic accountant, a business appraiser, and a restaurant consultant. Several party-engaged experts also testified at the hearing or in deposition.

Referee Chang's subsequent **30-page Report with Recommendations** recounts in detail the background facts, his findings of misconduct by Licul and Turcinovic, his computation of damages, and his recommendation that the court grant the Grgurevs' petition for equitable dissolution and award them 100% ownership and control of Delmonico's in lieu of dissolving the corporation and liquidating the business. The legal analysis portion of the Report at paragraphs 26-31 cites a mix of precedents concerning oppression, fiduciary duty, and equitable remedies in dissolution and non-dissolution cases involving corporations, LLCs,

and partnerships, but none compelling a buy-out of the respondent's shares in a case seeking dissolution of a close corporation.

The respondents' misconduct found by Referee Chang included:

- denying petitioners "prompt and meaningful access to the restaurant's financial books and records" and forcing them unnecessarily to bring judicial proceedings to obtain access;
- engaging in "a pattern of oppressive conduct toward Petitioners for the purpose of forcing Petitioners to surrender their 50% interest in Delmonico's to Respondents" including initially reducing and then terminating the Grgurevs' salaries and ceasing profit distributions while at the same time substantially increasing their own salaries;
- intentionally deleting point-of-sales data for the period prior to May 2018, giving rise to an adverse inference; and
- filing "retaliatory" counterclaims against the Grgurevs' wives and daughters.

Referee Chang also found that the Grgurevs failed to prove their contention that Licul and Turcinovic had "engaged in a panoply of fraudulent conduct to siphon off some $42 million from Delmonico's" including $21 million in vendor payments and almost $14 million in cash tips. Instead, he recommended that the court surcharge respondents almost $4.5 million as a result of excessive salaries paid to themselves and salaries and distributions withheld from the Grgurevs, and that the surcharge be applied as an offset against payment for the respondents' equity stakes in Ocinomled, leaving a deficiency judgment against them of approximately $1.9 million based on the Referee's $2,550,000 valuation of a 50% interest.

The Final Judgment

Justice Cohen issued an order in December 2020 confirming the Referee's Report and adopting its recommendations with one modification concerning application of the cash in Ocinomled's bank accounts as an offset to the $1.9 million deficiency judgment.

After further proceedings, late last month Justice Cohen entered a **Final Judgment** declaring that Ocinomled

> **"is equitably dissolved, such that any and all equity interests in Delmonico's of Respondent Milan Licul and Branko Turcinovic, of any class or kind, are**

forfeited in their entirety to Delmonico's, resulting in Petitioners Ferdo Grgurev and Omer Grgurev each owning 50% of the remaining outstanding equity interests in Delmonico's.

In addition to provisions concerning, among other things, cooperation in transferring property and records, indemnification, and noncompetition, the Final Judgment awards a money judgment against the two respondents for approximately $1.75 million.

Delmonico's Impact

The Delmonico's case breaks new ground in two respects. First, in upholding the petitioners' request for equitable dissolution, it enlarged standing to seek dissolution under the common law for 50% shareholders of a closely held New York corporation which, under the above-mentioned *Leibert v Clapp* case, is limited to minority shareholders.

Second, as far as I can tell, it's the first decision in a proceeding for judicial dissolution of a New York close corporation compelling the respondent shareholders to relinquish their shares. This is highly significant because, under well-settled case law, courts lack authority (i) to compel a buy-out in either direction in a dissolution suit by a 50% shareholder based on deadlock or internal dissension under BCL § 1104 or (ii) to compel a buy-out of the respondent by the petitioner alleging shareholder oppression under BCL § 1104-a. In the latter instance, the statute only gives to the respondent an elective right to purchase the petitioner's shares under **BCL § 1118**. The Delmonico's case thus stands shoulder to shoulder with *Mizrahi v Cohen*, its LLC case counterpart which also ordered a buy-out of the 50% respondent in the absence of statutory authority.

As of this writing Licul and Turcinovic have not filed a notice of appeal from the Final Judgment. Assuming they do, it's likely the appeal will concern only the Referee's valuation of the company, his damages assessment, and the proposed indemnification which were the only challenges Licul and Turcinovic raised in their post-hearing motion to modify the Referee's Report and Recommendations.

Not only that, nowhere in the proceedings below did I find any challenge by them to the Grgurevs' standing as aggregate 50% shareholders to seek common-law dissolution or to the court's legal authority to compel Licul and Turcinovic to relinquish their stock holdings in lieu of dissolving the company. On the contrary, in their post-hearing brief to the Referee, Licul and Turcinovic argued that, whichever side prevails, "it would be in the public interest

and the interest of this Court to have the famous Delmonico's restaurant continue in business" and that *they*, not the Grgurevs, should be awarded "sole ownership and possession" of the company's capital stock.

If I'm right, the prospect that Delmonico's-style equitable dissolution will become a regular item on the business divorce lawyer's menu will have to await future judicial consideration in cases not yet brought.

Update March 29, 2022: Both sides appealed from different portions of the trial court's decision, resulting in **today's ruling by the Appellate Division, First Department**, affirming the challenged rulings with one modification whereby the appellate court held that the plaintiff's were entitled to an equitable accounting.
