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Highlights

BNA Insights

N.Y. Court Adopts Del. 'Tooley' Test For Direct v. Derivative Claims, Tosses Suit

The New York Supreme Court, Appellate Division Aug. 7 adopted the Delaware *Tooley* test for determining whether a claim is direct or derivative (*Yudell v. Gilbert*, N.Y. App. Div., Index 600404/08, 8/7/12).

Applying the test, Justice Karla Moskowitz affirmed dismissal of claims related to the management of a joint venture's Long Island shopping center. Justices Peter Tom, David Friedman, John Sweeny, and Leland DeGrasse concurred.

The court explained that in 1965, Martin Yudell, Julius Yudell, Joseph J. Weiser, and I. Roy Psaty formed the joint venture Baldwin Harbor Associates (BHA). Julius Yudell, Joseph Weiser, and I. Roy Psaty are deceased.

The purpose of the joint venture was to construct and manage a shopping center, the court said. In 1991, BHA hired Jerrold Gilbert as managing agent for the shopping center. In 2008, the court noted, ''plaintiffs [trustees of the Julius Yudell Trust and Martin Yudell] brought this action against Gilbert individually, the other members of the joint venture and BHA as a nominal defendant. The complaint purported to bring both derivative and direct claims and pleaded demand futility.'' Among other specifics, the complaint asserted various causes of action based on Gilbert's alleged failure to collect appropriate rents, certain tax obligations, and common area maintenance charges from tenants.

The lower court determined that the causes of action at issue ''were derivative in nature and granted defendants' motions to dismiss [them] for failure to plead demand futility with the requisite particularity.''

The Framework of 'Tooley'

The appeals court affirmed the dismissal. In so ruling, the court adopted the test for determining whether claims are direct or derivative developed by the Delaware Supreme Court in *Tooley v. Donaldson, Lufkin & Jenrette Inc.*, 845 A.2d 1031 (Del. 2004) (19 CCW 116, 4/14/04).

New York, the court remarked, ''does not have a clearly articulated test, but approaches the issue on a case by case basis depending on the nature of the allegations.'' However, the court pointed out, Delaware provides the following framework in *Tooley*: 'A court should look to the nature of the wrong and to whom the relief should go. The stockholder's claimed direct injury must be independent of any injury to the corporation. The stockholder must demonstrate that the duty breached was owed to the stockholder and that he or she can prevail without showing an injury to the corporation.' ''

Thus, the court recapped, under *Tooley*, a court should consider '' '(1) who suffered the alleged harm (the corporation or the stockholders); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders individually).' ''

Applying a ''common sense approach, plaintiffs' claim for breach of fiduciary duty is derivative, because any pecuniary loss plaintiffs suffered derives from a breach of fiduciary duty and harm to the business entity, BHA, the court said. Plaintiffs' allegations of breach of fiduciary duty involve failure to

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collect rent, back taxes and common charges that tenants would have owed to BHA.''

Meanwhile, the court said that ''[t]o the extent, if any, that plaintiffs have asserted direct claims, they are embedded in an otherwise derivative claim for partnership waste and mismanagement. Accordingly, the motion court correctly determined that plaintiffs' causes of action are derivative and properly dismissed them because the complaint fails to plead demand futility with the requisite particularity.''

In a final note, the court said that because the dismissal below was not with prejudice, ''it is not necessary for us to reach plaintiffs' argument on appeal that they should be allowed to amend their complaint.''

Officers and Directors

Nev. Courts Can Have Jurisdiction Over Non-Resident Officers

Nevada courts may properly exercise personal jurisdiction over non-resident officers and directors who directly harm a Nevada corporation, the Nevada Supreme Court determined Aug. 9 (*Consipio Holding BV v. Carlberg,* Nev., No. 58128, 8/9/12).

Writing for the en banc court, Justice Mark Gibbons said that the lower court ''failed to conduct adequate factual analysis to determine whether [the district court] could properly exercise personal jurisdiction over the respondents before dismissing the complaint against them.'' The court thus vacated the dismissal order and remanded the dispute to the lower court for further proceedings.

Derivative Claims

The court recounted that appellants Consipio Holding BV; Ilan Bunimovitz; Tisbury Services Inc.; and Claudio Gianascio—collectively, Consipio—are shareholders of Private Media Group Inc.—PRVT. In August 2010, Consipio filed a complaint in Nevada state court, seeking injunctive relief and the appointment of a receiver for PRVT. Consipio also asserted derivative claims on behalf of PRVT against PRVT's former chief executive officer and president, Berth H. Milton Jr. (not a party to this appeal) and against officer and director respondents Johan Carlberg (PRVT director), Peter Dixinger (PRVT director), Bo Rodebrant (PRVT director), Johan Gillborg (former PRVT chief financial officer), and Philip Christmas (PRVT subsidiary chief financial officer).

The court explained that the claims focus on the respondents' alleged conduct in assisting Milton Jr. financially to harm PRVT for personal gain. Allegedly, the respondents assisted Milton Jr. in obtaining significant loans for himself and entities he controlled. The respondents also allegedly failed to demand repayment on these loans and helped Milton Jr. remove funds from PRVT and conceal the wrongdoing.

''Given these allegations, Consipio contends that respondents collectively have been guilty of misfeasance, malfeasance, and breach of their fiduciary duties,'' the court noted.

PRVT, the court wrote, ''is incorporated in Nevada with its principal place of business in Spain. Respondents are all citizens and residents of European nations.''

Nevada Citizen

Each of the respondents moved to dismiss the action against them for lack of personal jurisdiction. ''Without conducting an evidentiary hearing, the district court granted their motions and certified its dismissal orders as final under NRCP 54(b),'' the court wrote. It vacated the dismissal order and remanded for further proceedings.

The court said that a corporation that is incorporated in Nevada is a Nevada citizen. ''When officers or directors directly harm a Nevada corporation, they are harming a Nevada citizen. By purposefully directing harm towards a Nevada citizen, officers and directors establish contacts with Nevada and 'affirmatively direct[] conduct' toward Nevada,'' the court declared. ''When a cause of action arises out of an officer's or director's purposeful contact with Nevada, a district court can exercise personal jurisdiction over that officer or director,'' the court said.

The court also pointed out that NRS 78.135(1) authorizes lawsuits '' 'against the officers or directors of the corporation for violation of their authority.' '' The provision also ''supports a district court's authority to exercise personal jurisdiction over officers and directors in such lawsuits,'' the court said.

Finally, the court noted that the trial court remarked that an individual's position as a Nevada corporation's director does not automatically subject that individual to jurisdiction in Nevada. ''While we agree with this statement, the district court needed to conduct further factual analysis to determine whether the respondents' conduct subjected them to jurisdiction in Nevada,'' the court said. Thus, it remanded the dispute for further proceedings.

The decision is available at http://op.bna.com/ccw.nsf/r?Open=khyd-8xcmh5.

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SEC Enforcement

S.D.N.Y. Defends Rejection of Pact Between SEC, Citigroup

The U.S. District Court for the Southern District of New York Aug. 13 defended its rejection of a $285 million pact between the Securities and Exchange Commission and Citigroup to settle securities fraud charges, arguing that the parties mischaracterized the reasoning behind the court's order (*SEC v. Citigroup Global Markets Inc.*, 2d Cir., No. 11-05227, 8/13/12).

In a brief to the U.S. Court of Appeals for the Second Circuit, counsel for the district court contended that the parties wrongly assumed that Judge Jed Rakoff rejected the accord because Citigroup did not admit any wrongdoing.

''[A]s the district court's opinion repeatedly stated, the reason the court could not evaluate, let alone approve, the proposed consent judgment was because neither party had presented the court with any material facts whatsoever, and not because there had been a failure to admit liability,'' the brief by appointed pro bono counsel John Wing of Lankler Siffert & Wohl LLP in New York, said.

Despite due deference to the SEC, the judge had a responsibility to determine independently whether the settlement was fair, adequate, reasonable, and in the public interest. In this case, there was simply no evidence to guide such a determination.

However, Wing noted, now that a parallel SEC lawsuit against former Citigroup executive Brian Stoker has concluded, ''the district court has a substantial evidentiary record upon which to assess the proposed consent judgment on remand if the appeal is denied or dismissed.'' A jury recently cleared Stoker of any wrongdoing in connection with a $1 billion collateralized debt obligation that also formed the basis for the SEC's lawsuit against Citigroup.

Settlement Rejected

In November, Rakoff declined to approve the proposed agreement between the SEC and Citigroup to settle allegations that the bank misrepresented its role in the CDO that it structured and marketed in 2007 (26 CCW 361, 11/30/11). He reasoned that the parties provided scarce facts to determine the adequacy of the pact.

The court also faulted the SEC's long-standing policy of allowing defendants to neither admit nor deny allegations when entering into settlements. Rakoff told the parties to prepare for trial.

The SEC and Citigroup asked the Second Circuit to review the ruling, and in March, a panel stayed the proceedings, noting that the parties had made a ''strong showing'' that they would succeed in setting aside the lower court's order (27 CCW 89, 3/21/12).

In briefs to the Second Circuit, the SEC and Citigroup argued that the district court abused its discretion in striking down the agreement (27 CCW 162, 5/23/12). They contended that Rakoff's ruling set an ''erroneous'' bright-line rule that a settlement cannot be approved based on allegations unsubstantiated by ''proven or acknowledged facts.''

The brief is available at http://op.bna.com/ccw.nsf/r?Open=khyd-8x9mn5.

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Employment Policies

Who Owns Social Media Accounts: Company or Employee?

On their last day at work, after the office party, departing employees are routinely asked to provide their identification badges, computer passwords, and a forwarding address.

Should departing employees also be required to hand over the social media accounts they used to promote their companies on Twitter, LinkedIn, and Facebook? Who owns those social media accounts and the contacts accrued over the years?

The question is one facing Noah Kravitz and Linda Eagle. In separate lawsuits, Kravitz and Eagle have argued about the ownership of Twitter and LinkedIn accounts they used while on the job, and that their former employers believe they should have relinquished when they left their respective companies.

In each case, employers contend that the corporate social media accounts in question are valuable company property that employees could not take with them on their way out the door, any more than they could pocket a flash drive that stored sensitive corporate data.

The issues raised in the cases have vast implications, as more and more employees today are encouraged, or even required, as part of their jobs to market their companies through social media.

Keeping Twitter Followers

When Kravitz, who was hired by PhoneDog to promote the company on social media, left the job in October 2010, he changed his Twitter handle from @PhoneDog_Noah to @noahkravitz, thereby keeping the account's then 17,000 Twitter followers.

The U.S. District Court for the Northern District of California in January declined to dismiss PhoneDog's claims against Kravitz for misappropriation of trade secrets, intentional interference with prospective economic advantage, negligent interference with prospective economic advantage, and conversion (*PhoneDog v. Kravitz*, N.D. Cal., No. 3:11-cv-03474-MEJ, 1/30/12).

According to the case docket, the dispute is in mediation.

LinkedIn Account Disputed

In another case, Linda Eagle has battled with EdComm Inc. over her LinkedIn account, which the company argues contains valuable business information. Eagle alleged that EdComm improperly changed the password on her personal account and replaced her photo and the name attached to the account with a former colleague who was appointed interim

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chief executive officer for the company after Eagle was fired.

The U.S. District Court for the Eastern District of Pennsylvania let EdComm's misappropriation of an idea and unfair competition counterclaims go forward, but rejected conversion and misappropriation of trade secrets claims (*Eagle v. Morgan*, E.D. Pa., No. 2:11-cv-04303-RB, 12/22/11).

The court is considering EdComm's summary judgment motion, according to the case docket. If the matter is not dismissed, it is slated to proceed to trial on Oct. 16.

Who Owns the Account?

The cases highlight the need for employers to set policies governing ownership of social media accounts.

Adam S. Forman, of Miller, Canfield, Paddock & Stone PLC, Detroit, told BNA Aug. 14 that ''a lot could have been avoided'' in *PhoneDog* and *Eagle* if the companies had comprehensive policies governing social media accounts. Forman said such policies could be stand-alone or joined with other company policies, but he favors the stand-alone approach.

Forman stressed that the most important objective for a company is to ''think through these issues,'' and the ''biggest mistake is they don't consider'' establishing a social media policy. Such a policy might treat a corporate social networking account like a firm laptop or business email address that an employee would be expected to surrender at the exit interview.

Susan Gross Sholinsky and Maxine Neuhauser, with EpsteinBeckerGreen's New York and Newark, N.J., offices, similarly told BNA in an Aug. 14 email that a corporate policy is vital.

''Where the employee is Tweeting, maintaining a LinkedIn page, or otherwise posting to a branded social media site, the employer should require the employee to sign an agreement specifically acknowledging that (i) the Twitter, LinkedIn, Facebook, etc. account belongs to the employer (and not to the employee), (ii) the employee is posting to the account on behalf of, at the request of, and in connection with his/her employment with, the employer, (iii) the account is the property of the employer, and that (iv) the employee understands that, upon termination of employment for any reason, the account will stay with the employer, and not follow the employee,'' they said.

Sholinsky and Neuhauser also suggested that the agreement ''require the employee to provide the employer access to the account at any time, including providing passwords. The employee should be required to provide his/her supervisor, or other designated individual, with current passwords for the social media accounts.''

Hugh C. Carlin, of Gross Shuman Brizdle & Gilfillan PC, Buffalo, N.Y., told BNA Aug. 15 that in addition to advising creation of corporate social media policies or contracts, he has proposed that clients tell employees to create separate social networking accounts for personal use and business purposes.

An employer should ensure it has access to the company account's password at all times and impose an obligation on an employee to let it know if the password has changed, he said. There should not be one ''cookie cutter'' social media policy but instead policies that specifically address each platform, according to Carlin.

How to Deal With Departure

Joshua Briones and Anahit Tagvoryan, both of DLA Piper's Los Angeles office, said there is a need for company policies and agreements with provisions specifying corporate ownership of social media accounts used by employees for business purposes. They added that a company should change the account password when an employee departs.

According to Sholinsky and Neuhauser, dealing with these matters at the front end, when an employee's corporate social media account is created, is the best course of action.

However, if a company failed to set a policy up front, they suggested ''that the employer remind the employee of the existence and terms of the applicable agreement(s), and how those terms will play out in practice. Such instruction may occur during an in-person exit interview or in writing (i.e., a 'reminder letter'), or both.''

An employer, they added, might also rename the account and send a message to all followers or links announcing the change in name and who might be taking over the account.

Carlin said that companies offering severance pay to a departing employee probably should consider making one condition of the payment that the employee disclose all social media account passwords and any other changes to the account the employer deems important.

Blurred Private, Public Lives

Because of the rapid development of social media, many employers probably have not yet set up policies governing ownership of accounts. Many employers also may have permitted employees to use their private social media accounts for company purposes, such as marketing, resulting in a blurring of personal and private lives on social media accounts.

''The situation becomes more complicated where the employee is posting to his/her own account, such as a personal LinkedIn account. In such circumstances, it will be much more difficult (if not impossible) for a company to assert ownership of the social media site. In this situation, the employer may be best served by a confidentiality agreement prohibiting employees from disclosing trade secret and proprietary information, which, in some businesses, could include the identity of customers and could form the basis for prohibiting employees from, for example, 'friending' or 'Linking In' with company clients,'' Sholinsky and Neuhauser said.

Forman noted that Kravitz's answer and counterclaim in the *PhoneDog* case stressed what the former employee felt was the private nature of the account. Kravitz's filing said he ''used the [@PhoneDog_Noah] Account to share information concerning his life, opinions, work and a variety of other subjects—for example, his favorite TV shows, sports teams and music. Kravitz estimates that more than 50% of the tweets from the Account were personal in nature and completely unrelated to PhoneDog.''

Similarly, Eagle commented on the personal aspects of her LinkedIn account in her complaint. She said she ''used LinkedIn not only for purposes of promoting EdComm's banking education services, but also to foster her reputation as a businesswoman; to reconnect with family, former friends, and colleagues; and to build social and professional relationships.''

What Is the Monetary Value?

The cases also raise the question of why a company might zealously guard a social media account. Indeed, one issue the federal court dealt with in *PhoneDog* was whether it even had diversity jurisdiction over the case, which requires an amount in controversy of at least $75,000.

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PhoneDog argued that a Twitter account is valuable, and at the time of its complaint said it had suffered $340,000 in damages over eight months. To obtain that figure, it used what it called an industry standard valuation of $2.50 per Twitter follower per month. Because Kravitz's account had approximately 17,000 followers, the monthly damages were alleged to be $42,500.

Kravitz disputed the notion there was any evidence that a Twitter account has a monetary value. If it does, he said, ''it requires more than simply multiplying each user by $2.50; rather multiple factors must be considered, including: (1) the number of followers; (2) the number of tweets; (3) the content of the tweets; (4) the person publishing the tweets; and (5) the person placing the value of the account.''

Carlin added that a company may have invested time and resources in a social media account. In many companies, he noted, ''it may be very likely that someone else drafted the tweets'' and another employee—not the person officially attached to the account—may have invested company time to amass a large number of followers. The company thus is spending a great deal of money developing goodwill.

Outcome Hard to Predict

Experts also told BNA that it is hard to assess the strength of the company's case or employee's case in *PhoneDog* and *Eagle*.

Carlin said it may be hard for an individual to bring the same legal resources to such a case that a corporation could, and added that the docket showed Eagle was now pursuing her case pro se.

Sholinsky and Neuhauser also noted that the cases were expensive and an ''uphill battle for the party who has lost control of the account(s) in question.'' The determination of the claims likely would center on ''whether (i) there is a written agreement clarifying ownership rights to the accounts, (ii) the account was used for both personal and business purposes, (iii) the accounts were managed by others besides the employee, and (iv) the company asserted ownership over the account(s) immediately upon the employee's departure.''

BY MICHAEL O. LOATMAN

In Brief

SEC to Vote on Reg D Proposal, Not Interim Rule

Rather than adopt interim final rules as some had predicted, the Securities and Exchange Commission will vote Aug. 22 on a proposed rulemaking to lift the ban on general solicitation and advertising pursuant to the Jumpstart Our Business Startups Act. When the SEC announced the open meeting in July (27 CCW 205, 7/4/12), some predicted that the commission would forgo notice and comment rulemaking and adopt interim final rules, given the time pressures facing the agency. The JOBS Act gave the commission 90 days to lift the bans on general solicitation and advertising for offerings conducted under Regulation D Rule 506 and 1933 Securities Act Rule 144A. However, the agency is more than a month behind schedule.

PCAOB Releases Guide for Audit Committees

The Public Company Accounting Oversight Board Aug. 1 released a primer about its inspection process and the meaning of reported inspection results that it hopes will enable audit committees at public companies to have meaningful discussions with auditors. ''Whether an Audit Committee's own company audit is being reviewed as part of an inspection, or whether it's another company within the same industry, PCAOB inspection reports provide insight into areas of risk and audit quality that are of concern to all Audit Committees,'' PCAOB Chairman James R. Doty said during an Aug. 1 conference call. The release provides information about the meaning and significance of PCAOB inspection findings in the context of both engagement reviews and quality control reviews.

House Dems Give Wal-Mart Last Chance to Cooperate in Probe

Two House Democrats investigating possible Foreign Corrupt Practices Act violations by Wal-Mart Stores Inc. told the company Aug. 14 that it had one ''final opportunity'' to cooperate fully in the investigation before the lawmakers release their findings and publicize documents obtained in the probe. In April, Reps. Elijah Cummings (D-Md.) and Henry Waxman (D-Calif.) announced an investigation into allegations that the retail giant covered up a massive bribery scheme in connection with its rapid expansion in Mexico (27 CCW 140, 5/2/12). At that time, the company also revealed that it was meeting with the Securities and Exchange Commission and the Justice Department regarding its internal investigation of FCPA compliance. In an Aug. 15 e-mail to BNA, Wal-Mart spokeswoman Brooke Buchanan said, ''We want to provide Members of Congress with whatever appropriate information we can to help them understand our efforts to address compliance issues.'' Wal-Mart has until Aug. 28 to respond to the lawmakers' request.

State Court May Exercise Jurisdiction Over Malpractice Lawsuit

A state court may exercise jurisdiction over a malpractice lawsuit based on lawyers' alleged mishandling of antitrust litigation in federal court, the Texas Court of Appeals, First District, decided July 26. The mere fact that a professional negligence claim arose out of a failed federal antitrust lawsuit does not confer exclusive subject matter jurisdiction over the claim upon federal courts, Justice Michael Massengale said. Rather, state courts have ''presumed concurrent jurisdiction'' over a state-law malpractice claim in this situation, and the presumption may be rebutted only by ''explicit or implicit Congressional directive . . . or by a clear incompatibility between state-court jurisdiction and federal interests,'' Massengale stated. Here, the court found no congressional intent to confine all lawsuits arising out of antitrust laws to federal tribunals (*In re Haynes and Boone LLP*, Tex. App. 1st Dist., No. 01-12-00341-CV, 7/26/12).

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dissolution requires more than lack of profitability or disagreement among the members of the entity as to the distributions of the entity's revenues or the sale of its assets. For example, in *Schindler v. Niche Media Holdings, LLC*,[3] a New York court found, in the context of a request for a preliminary injunction, a cause of action unlikely to be successful on the merits that requested dissolution of a company as the only way for the plaintiff to obtain a meaningful return on his investment. Because the investor held only approximately 35 percent of the equity in the entity, he had no ability to force dissolution. Moreover, because the entity was both operating without difficulty and in fact generating meaningful profits, the court found that there was no basis to conclude that continuance of the entity's operations would not be "reasonably practicable."

In another case, *Baldwin v. Miller*, applying a similar Oklahoma law, the Tenth Circuit found no basis for judicial dissolution even by a limited partner owning 99 percent of the interests in the partnership, because the general partner could and was in fact continuing to operate the partnership for the purposes for which it was constituted.[4] The Tenth Circuit so found even though the partnership was organized for estate planning purposes and the limited partner was the intended beneficiary of that estate planning.

In at least one case, however, a court did find that the continued operation of the entity would not be "reasonably practicable." In *Matter of Youngwall*,[5] the issue before a New York court was the operation of a limited liability company, the major asset of which was a piece of real property. The petitioner was one of two members of the entity. Because the consent of both members was required to lease the real property and because that consent was not available and would not be available for the foreseeable future due to the conflict between the members, the court did find that the continuance of the entity was "not practicable" and ordered dissolution.

As can be seen from these decisions, courts have imposed a relatively high standard for dissolution on the basis that operation of the entity is "not reasonably practicable." Disagreement among the members over the entity's day-to-day operations or the distribution of its assets are clearly insufficient. Rather, the disagreement among the members must rise to the level of deadlock and that deadlock must completely frustrate the operations of the business. In professional practice, such deadlock might be achieved by stopping payments to vendors or staff, a result that a member lacking the power to force dissolution might be able to achieve by refusing to authorize such payments. Obviously, such steps would have drastic effects on the value of the practice and likely the ability of the members to continue to practice. Moreover, given that such steps might interfere with patient care or provision of services to clients, for ethical reasons the intentional manufacture of such "deadlock" may simply be unavailable for entities whose membership consists of professionals.

Other bases for dissolution may be available in particular cases. New York law, and the law of many other states, allows a member to petition for dissolution of a partnership upon the occurrence of certain events, such as the incompetence of another member or the commission of wrongful acts by the member against the entity.[6] Partnerships without written agreements are dissolved without the need for court intervention, simply by the withdrawal of the partner. Such avenues for dissolution, however, will not be available in most cases.

Other Remedies

A member accordingly may be unwilling to seek judicial dissolution because of the risk of injury to the practice itself. The member seeking relief may in fact be a majority owner of the entity, or be part of a group possessing as a whole majority or supermajority ownership, but still be unable, for the reasons described above, to successfully petition a court for judicial dissolution.

This does not, of course, mean that no remedy is available at law for members in limited liability companies or partnerships. Frequently, the same issues that may give rise to a desire to dissolve an entity may themselves be amenable to resolution by legal process without the drastic remedy of dissolution. Members can continue to work together even as they are involved in litigation. Some of those potential causes of actions are discussed below.

Breach of Fiduciary Duty And Breach of Contract Claims

It is beyond question that coventurers in a professional practice, whether organized as a limited liability corporation, a limited liability partnership, or otherwise, owe each other fiduciary duties. While not every dispute arising in such an entity will result in a breach of a fiduciary duty, this duty sets meaningful limits on the actions that members can take against one another.

For example, an inequitable distribution of the entity's profits can constitute a breach of fiduciary duty, even if it is supported by a majority vote of the membership. In a Massachusetts case, *Ellis v. Varney*,[7] the court found in favor of a minority shareholder on her claims that certain "incentive bonus" payments to the majority shareholders in a closely held corporation [8] were not appropriate and that the money paid for such bonuses should have been included in "surplus funds" and apportioned among all the shareholders.

Moreover, requests for such relief need not be limited to money damages. In *Old Colony Ventures I v. SMWNPF Holdings*, a federal district court held that even a provision in a partnership agreement that provided that a partner's approval of a particular course of action was at its "sole and absolute discretion" would not allow a partner to withhold approval in a way that contravened the best interests of the partnership or of the other general partner, and allowed the case to go forward.[9]

[3] 772 N.Y.S.2d 781 (N.Y. Sup. Ct. 2003). It should be noted that in *Matter of Dissolution of 1545 Ocean Ave., LLC*, 893 N.Y.S.2d 590 (N.Y. App. Div. 2010), the Second Department found that under New York law, the standard for dissolution of a limited liability corporation is higher than for a business corporation or partnership. Accordingly, at least in New York, a somewhat different standard may apply for dissolution of a partnership.

[4] 593 F.3d 1155 (10th Cir. 2010).

[5] 2008 BL 63420 (Sup. Ct. Nassau Cty. March 14, 2008).

[6] N.Y. P'SHIP LAW § 63(d)(1) (2012).

[7] 17 Mass. L. Rep. 394 (Mass. Super. Ct. 2004).

[8] Significantly, for our purposes, the court held, "In a close corporation, the controlling stockholders owe minority stockholders the same fiduciary duty of utmost good faith and loyalty that partners owe to one another."

[9] 918 F. Supp. 343 (D. Kan. 1996).

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Accordingly, in an appropriate case, a member of a professional practice can take legal action seeking specific relief for such breaches to address the problems that have arisen in that entity without necessarily requesting that the court impose the drastic remedy of dissolution.

As noted above, courts have generally allowed a free hand in the drafting of operating agreements for limited liability partnerships and limited liability companies. Accordingly, a full discussion of potential actions for breach of such agreements is impossible here. Nonetheless, such contracts frequently require that members dedicate their best efforts to the entity to the exclusion of other enterprises, to refrain from illegal or immoral conduct, and to maintain appropriate professional credentials. In an appropriate case, such provisions may also provide an avenue for relief.

Declaratory Relief As to Scope of Non-Compete

Courts have generally held that a declaratory judgment action is available and ''ripe'' for judicial decision-making if the plaintiff states his or her intention to leave the entity and take some step towards beginning work elsewhere. For example, the plaintiff in *Arakelian v. Omnicare* [10] had sought a position at a competitor and was otherwise unequivocal in her desire to start work that would potentially violate the non-compete clause. The court found plaintiff's actions presented a sufficient case or controversy to allow for a judicial decision. The court went on to find the covenant at issue to be unenforceable because the employee had been terminated involuntarily.

Insofar as covenants not to compete are required to be ''reasonable'' in the terms of their geographical, temporal, and scope of activity limitations, a favorable declaratory judgment may assist a member in deciding whether or not to withdraw from an entity. While beyond the scope of this article, poorly written or overbroad non-competes may be found to be completely unenforceable.[11]

[10] 735 F. Supp. 2d 22 (S.D.N.Y. 2010).

[11] It should be noted that in New York and many other jurisdictions, non-compete covenants cannot be enforced against employees who are involuntarily terminated.

Negotiation

Given the difficulty, on the one hand, of obtaining dissolution by judicial decree, and given the dire results, on the other, that dissolution threatens to those members who wish to continue the entity, the obvious choice for all parties is to achieve some kind of negotiated resolution. Non-compete clauses can be eliminated or modified, assets divided, the future care of clients or patients discussed, without the need for prolonged and expensive litigation and without the threat of dissolution hanging overhead. After all, it seems self-evident that members who no longer wish to be in business together should not be.

This observation brings us back to the observations made at the beginning of the article. Given the high stakes involved for every member of an entity, regardless of the ill will that may have developed between members, litigation should really be seen as a last resort to bring parties to the negotiating table and not as the most effective way to resolve such disputes.

Internal Controls

Oracle to Pay $2 Million To Settle SEC FCPA Lawsuit

Software giant Oracle Corp. agreed Aug. 16 to pay $2 million to settle a Securities and Exchange Commission lawsuit over the company's alleged violations of the Foreign Corrupt Practices Act for failure to record properly ''secret side funds'' created by its subsidiary in India, the agency announced that day (*SEC v. Oracle Corp.*, N.D. Cal., 12-04310, 8/16/12).

According to the SEC's complaint, filed in the U.S. District Court for the Northern District of California, the funds were improperly ''parked'' with Oracle India Private Ltd.'s distributors, off Oracle's books, in violation of the FCPA's books and records provisions. The funds then were used to pay ''phony vendors,'' creating the risk that bribery or embezzlement could take place, the SEC said.

Oracle neither admitted nor denied the allegations.

'Parked' Funds

The SEC alleged that Oracle India entered into multiple sales contracts with the Indian government through local distributors. Certain Oracle India employees directed the distributors to hold the margin between the end-user and distributor prices in ''side funds,'' the agency said. The funds accumulated roughly $2.2 million between 2005 and 2007.

The distributors allegedly used the funds to pay third parties, ''purportedly for marketing and development expenses.'' However, the SEC said, some of the third parties did not exist, and others were not on the company's list of approved vendors. Moreover, the distributors allegedly provided fake invoices for some of the payments.

''Oracle India's parked funds created a risk that they potentially could be used for illicit means, such as bribery or embezzlement,'' the SEC said.

The funds should have been recorded as an asset, the SEC said, and reflected in Oracle's ''income statement once they were used.''

SEC Faults Lack of Controls

In addition, the complaint alleged that Oracle lacked the internal controls to prevent Oracle India employees from ''creating and misusing'' the side funds. The SEC faulted the company for allegedly failing ''to audit and compare the distributor's margin against the end user price to ensure excess margins were not being built into the pricing structure.''

In addition to the $2 million penalty, Oracle agreed to be permanently enjoined from future violations. The SEC noted that the settlement took into account that the company voluntarily disclosed the issue after an internal investigation, fired the employees responsible for the alleged conduct, and made ''significant enhancements'' to its FCPA compliance program.

In an email to BNA, Oracle spokeswoman Deborah Hellinger said Oracle discovered the matter in 2007 and terminated the employees following a ''thorough investigation.''

''Oracle disclosed the matter to the government and has cooperated with the SEC in its investigation, culminating in today's announcement of a $2 [million] settlement,'' she continued. ''Oracle has established policies, programs and controls to deter and detect inappropriate conduct that has been recognized among the best in our industry.''

BY MARIA LOKSHIN

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BNA Insights

Disputes in Small Professional Practices: A Strategy Guide

BY ANDREW ST. LAURENT

Disputes between members of small professional practices present unique challenges, challenges that have been further complicated by recent court decisions limiting the availability of judicial dissolution for limited liability companies and partnerships. This article will attempt to describe a framework in which such disputes can be resolved.

Professional practices are usually organized as either limited liability corporations or limited liability partnerships, forms that give significant leeway to drafters in making key decisions about corporate governance. Furthermore, because these agreements most often limit the addition of new members as well as the sale of existing members' shares, interests in such entities are generally illiquid.

Non-compete covenants, which are enforceable against professionals such as dentists and doctors, may even restrict members' ability to abandon their interest and ''walk away.'' These agreements also frequently limit the removal of an existing member by requiring a supermajority vote or otherwise.

These types of agreements can result in volatile litigations that more closely resemble divorces than ordinary commercial litigation. Many of the same forces that drive clients in family law cases drive litigation in the context of small professional practices: the effects of aging, declines in productivity or professional competence coming from drug or alcohol abuse, or the need or desire of one member to leave the geographic location.

The ways in which these disputes are resolved are various but align themselves into several basic categories: dissolution, actions for money damages, and actions for declaratory or injunctive relief, typically going to the enforceability of non-compete clauses.

Dissolution

The best route for the exiting member (member is used throughout for partners or shareholders in such entities) is almost certainly dissolution. The winding up of the professional practice results in the distribution of capital accounts and other assets by equity ownership. Because the entity no longer exists, covenants not to compete will go unenforced and no obligation is owed the entity to refrain from marketing to former clients or patients.

Given the high stakes involved for every member of an entity, . . . litigation should really be seen as a last resort to bring parties to the negotiating table and not as the most effective way to resolve such disputes.

For members looking to continue a professional practice, however, such dissolution can be disastrous. Dissolution, like bankruptcy, will generally void leases and accelerate payments owed on outstanding loans. To the extent that the practice had ''going concern'' value in the form of reputation or otherwise, dissolution will compromise or destroy that value. Members who have practiced comfortably for decades may be threatened with the loss of their working space, their brand and reputation, and their capital structure, as well as the erosion of their client list.

Dissolution, however, is not easily achieved. The law typically provides that a limited liability company or limited liability partnership can be dissolved only as provided for in the operating agreement or by judicial decree. The operating agreements that govern most professional practices provide for dissolution only under very limited circumstances, typically either by supermajority or even unanimous vote. Accordingly, given that the member seeking dissolution usually lacks that level of control, dissolution under the agreement will almost never be available.

Judicial dissolution presents a path fraught with difficulties of its own. The New York law on judicial dissolution of limited liability companies, which is substantially similar to the provision governing the dissolution of limited liability partnerships, and typical of such laws, provides as follows: ''On application by or for a member, the supreme court in the judicial district in which the office of the limited liability company is located may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement.'' [1]

''Not reasonably practicable'' is not further defined by the act and is, to say the least, open to interpretation.[2] The courts that have addressed this provision have held that

(continued on page 262)

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[1] N.Y. LTD. LIAB. CO. LAW § 702 (2012).

[2] Such provisions differ meaningfully from those governing the judicial dissolution of corporations, which generally turn on more readily apparent benchmarks, such as the assertion by a certain percentage of shareholders as to the inability of the board of directors to take action or the inability of the corporation's shareholders to elect a board (*see, e.g.*, N.Y. BUS. CORP. LAW § 1104 (2012)) or petitions by shareholders to dissolve the corporation based on fraud or looting by the directors (*see, e.g.*, N.Y. BUS. CORP. LAW § 1104-a (2012)).

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