DOLGIN PROFESSIONAL CORPORATION
BUILD A BETTER BUSINESS

Managing the Corporate Divorce

Introduction

If you had told me at the outset of my career as a corporate lawyer that I would be spending almost as much time helping clients exiting from unhappy relationships as I would be helping them create new businesses in the first place, I would not have believed you for a minute. However, managing corporate divorces is now a big part of my world and is merely reflective of the simple fact that all things in life (and business) have a beginning, middle and an end. Frankly, understanding that all business relationship will have an ultimate end (either amicable or otherwise) is extremely helpful as it forces the professional advisor to ensure that "the exit" is considered (and hopefully addressed) in the initial planning phases.

In my experience, there are three (3) key stages to every corporate (or business) divorce: (a) dispute recognition, (b) dispute assessment/strategy and (c) dispute management. The purpose of this article is to provide you with some guidance across each of these stages so you can, as a professional advisor, help your clients better.

This article assumes that the dispute in question involves shareholders of a corporation but many of the principles discussed below are equally applicable to partnership or other types of business break-ups.

One key question for all professionals to consider at the earliest opportunity is "who do I act for"? Often I find that my primary role as corporate counsel creates a conflict of interest that precludes me from providing confidential and privileged advice to a particular shareholder (or group of shareholders) without consent from the opposing shareholders.

Dispute Recognition

Let's face it … shareholder disputes don't just happen. There are almost always "early warning signs" which are visible to the keen observer. In fact, in my experience three (3) factors easily and frequently lead to corporate break-ups: (a) resentment (i.e., I am doing more work than you are and I don't want a free-rider), (b) ego (i.e., I am more valuable to the business than you are) and (c) independence (i.e., I can run this business without you as I control all the key relationships with customers, etc.). These factors can arise whether or not all shareholders are active in the business but are more likely to surface when at least one significant founder shareholder becomes less active in the business.

These factors often contribute to the following "early warning" behaviours:

- withdrawing from daily activities;
- excluding other owners from key decisions and relationships;
- forming new alliances with other owners;
- collecting information in a secretive manner; and
- seeking unilateral discussions with professional advisors.

What is very clear (and understandable) is that parties often suffer for many years in an unhappy business relationship before they seek advice on how to deal with it (either as the one initiating or responding to the "first move").

Dispute Assessment & Strategy

Once you realize that you have a shareholder dispute on your hands, the next stage is the most critical – i.e., assessing your client's relative options, leverage and objectives. Then (and really only then) will you and the other members of the client's professional advisory team be in a position to provide any meaningful "advice" on the strategic considerations which will need to be engaged in to attain those objectives. This assessment exercise will often involve accounting, legal and valuation professionals.

Generally speaking, options to resolve shareholder disputes will require you to understand if your client first desires reconciliation of the relationship or not. If reconciliation is desired, then the discussions will focus on what is necessary to repair the relationship. More often then not, the client wants to exit the relationship (but not necessarily the business). Here are some key questions to facilitate getting instructions and understanding next steps at this all-important juncture:

- does your client expect a "war" or just "healthy" negotiations?
- is your client a natural buyer or seller? which does he/she prefer?
- what is the business worth? does your client have a magic number and, if so, what is the justification/basis for same?
- is there a written shareholder agreement? if so, what liquidity provisions does it contain (if any)?
- is the dispute among all or some shareholders? if only some, what is the position of the unaffected owners?
- what is the relative bargaining strength of the parties in dispute?
- are bank or other corporate guarantees in place?
- how are the other parties likely to "play'?

Dispute Management

Once it is determined (based on a thorough gathering of all relevant facts) what range of outcomes and objectives your client desires, the next step is to put together a joint plan of action. This may involve triggering a shot-gun clause in a shareholder agreement or tabling a non-binding letter of intent or commencing litigation.

Regardless of what outcome your client desires, unless he or she has the contractual right to compel that particular outcome (e.g., rights under a shareholder agreement), he or she must take steps to bring the other side to the dispute to the proverbial “table”. Generally, people only do things because they want to or they have to … it’s the classic “carrot” or “stick” dilemma and this is important to understand in the context of resolving shareholder disputes.

The key to “managing the process” is to get everyone to the table and keep them there until a deal is concluded.

Conclusion

In the end, most shareholder disputes are really just disguised sale transactions in which it is often unknown to everybody at the outset who is selling, who is buying, what’s the final price, how long will it take to close and how much will be spent on professional costs when we are all done. While this article just barely scratches the surface, hopefully it will provide you with a very basic framework to better approach these recurring client circumstances.

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