How To Avoid Costly Partnership And Shareholder Disputes, But How To Come Out Ahead If Fighting Is Unavoidable

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In the last edition of this publication, I wrote about how to start your new restaurant or food industry business on the right foot by creating a strong and complete owners' agreement to govern the ownership and management of the business. Whether you decide to form a partnership, LLC or corporation, the key to happiness between co-owners is a good, strong Partnership Agreement, LLC Operating Agreement or Shareholders Agreement, as the case may be. If you took, my advice, you are way ahead of the game.

In this issue, I am going to talk about what you should do if you find yourself in the undesirable position of being in a stalemate with your co-owner over important business decisions. I will discuss some strategies for avoiding costly, time-consuming and business-crippling litigation with your co-owner, how to minimize expenses if litigation occurs, and how to position yourself for maximum advantage if litigation looks to be inevitable.

As an initial matter, if you have either no agreement or one that is silent about how, where and when owner disputes are resolved, you and your partner will be left to resort to the remedies and relief offered by the various New Jersey statutes that govern corporations, partnerships and LLCs. Unfortunately, in most cases, the relief and remedies provided by those statutes are relatively weak, "one size fits all" provisions designed to provide a standardized set of rules, in contrast to the customized remedies you and your partner could devise *before* any trouble starts. You and your partner will be much better served if you execute a strong agreement now, if you have not already done so. It is never too late to do that before problems between you and your partners arise. Once you start to disagree about important business issues, it really is too late because the two of you will rarely, if ever, agree on anything thereafter.

Unfortunately, many once-happy business partners reach the conclusion at some point in the life of their business, for a variety of reasons, that they must go their separate ways. You may reach the decision yourself that you want out, or that you want your partners out. Alternatively, your partner may send you signals, by words or actions, that he wants you out. Sometimes the dispute is caused by one partner believing he is working harder than his partner. Or, it could be that one partner wants to retire, while the other wants to continue the business, or one wants to expand while the other wants to stand pat. Or, it could be any number of other issues, big or small, that lead the formerly happy co-owners to seek to dissolve their relationship.

My analogy to a family divorce is no accident; I have litigated many business "divorces" that were every bit as bitter and intensely fought as the most hotly contested family divorce. I have watched former best friends disagree with reasonable proposals out of pettiness and spite, just because the proposal was made by the other partner, even when the proposal would actually benefit the objecting partner. In addition, the fights are always over the same kinds of things that married couples fight about when going through a divorce, i..e. money and "custody" of the business. Finally, as in family divorces, feelings get hurt, trust gets violated, fragile egos get bruised and, frequently, dirty linen gets aired publicly, any of which can make it impossible to mend the rift between the owners. Once that ball starts rolling down the hill, it is very difficult to stop it.

What should you do when you reach this unfortunate crossroads in your business? Your first goal -- and the golden rule of closely-held business disputes -- is: Thou Shalt Avoid Litigation At All Costs, If Possible. Trust me on this one; you do not want to litigate these disputes unless you have no other option. Litigation is not only expensive, but it is also a huge distraction for business owners, who end up spending more and more of their time worrying about litigation issues -- depositions, interrogatory answers, motions and numerous other legal distractions -- and less of their time worrying about what they **should** be worrying about: their business. I have counseled numerous clients over the years who were getting dangerously obsessed with their litigation, while their real business was suffering. Finally, the outcome of litigation is always unpredictable, a word that makes most careful business people cringe. It is not at all rare for both parties in a lawsuit between partners to walk away from it very unhappy with the outcome.

Nonetheless, despite your best efforts, sometimes litigation is unavoidable. Your partner might cast the die for you by filing suit against you, or litigation might be the only feasible way to resolve your differences, or it might be mandated by your agreement when there is a management deadlock. For example, litigation might be your only resort if your partner decides to lock you out of your business. Or, you might need to run into court quickly to get a restraining order to stop your partner from depleting the business's bank accounts. If that is the case, the second golden rule of business partner disputes is: Thou Shalt Be The First One To Court (Or To Demand Arbitration), Whenever Possible, If Litigation (Or Arbitration) Is Inevitable. This rule is especially important if you do not have a strong business agreement; i.e., one that specifies the how, where, who and when of dispute resolution procedures. In either event, in situations where you have multiple options for how to conduct the litigation, you are better off being the one who decides which of those options to pursue. As the plaintiff, you get to define the dispute in your terms, rather than your partner's, and, in your complaint, which is the first document that the judge or arbitrator sees, you get to portray yourself as the white knight and your partner as the cause of all that is wrong with your business. Of course, you should fully expect your partner to defend herself and counterattack, but picking the battleground and being the partner who establishes the first agenda for the war can give you many strategic advantages throughout the litigation. As in sports, having the home court advantage in business litigation can tilt a close contest in your favor.

If you find yourself in the unfortunate position of having to weigh your options for resolving serious disputes with your partner, with litigation being among the options, the first thing you have to do is look at your owners' agreement to see what it says about disagreements between owners. Even if litigation can be avoided through negotiation resulting in an amicable settlement of the dispute, knowing what your agreement provides will help you negotiate more effectively.

First, review your entire agreement, paying particular attention to provisions such as the following. What mechanisms are provided to resolve disagreements? For example, does your agreement require mediation as a first step in the event of a stalemate or deadlock and, if so, what must you or your partner do to initiate it? Is a mediator identified in the agreement or is there a procedure spelled out for selecting one? Alternatively, does the agreement mandate either arbitration or litigation and, if so, is a particular court or tribunal specified? Does it specify what laws will be applied to the dispute? This can be an important variable, because the laws that govern closely-held business disputes can vary significantly from state to state. The more specificity in the agreement, the more certainty you will have about such things as where and how the battle will be fought and what body of law will apply, and the less time and money you and your partner will spend fighting about procedural, non-substantive issues.

You should also check to see if your agreement identifies who makes what decisions for the business. If so, has your partner usurped your responsibilities and rights to make certain decisions for the business? Again, the more specific your agreement, the better chance you will have if the dispute ends up in a legal battle. Similarly, has your partner failed to satisfy one or more of his obligations under the agreement; for example, a failure to make a required capital contribution? If so, does the agreement specify a remedy for your partner's breach? A breach by your partner of one or more obligations under the agreement is one potential basis for you getting into court first.

Are there conditions or requirements in your agreement that must be satisfied before you can avail yourself of one or more dispute resolution mechanisms? As noted above, some agreements require the owners to participate in mediation before arbitration, and/or arbitration before litigation. Other agreements require that notice and an opportunity to cure the default or breach be given to the offending partner. Contrary to the second golden rule recited above, you do not want to be the one to start litigation if you have failed to satisfy a prerequisite. Filing a complaint in court before you have satisfied all conditions or requirements puts you at risk of having your complaint dismissed. Not only is this a waste of your money and time, but it also starts you off on the wrong foot, which is never a good strategy. You will have given your co-owner an opportunity to win the first battle in court and thereby cast himself in the judge's eyes as the righteous partner.

Finally, does your agreement provide for an award of attorney's fees and costs of litigation to the prevailing party or, similarly, does it give the judge or arbitrator discretion to award attorney's fees? If either is the case, you will have to weigh very carefully your chances of success in an upcoming litigation, because an award of attorney's fees against you will make an already expensive proposition even more costly. In my experience, in most partner disputes, both sides have skeletons in their closets and reasons to fear a negative outcome. Such a provision can actually serve as a strong incentive to all parties to settle before subjecting their dispute to the vagaries of litigation.

After reviewing your agreement carefully, the second thing you must do if your partner has sued you, or you want to sue your partner, is to hire a lawyer who is experienced in handling litigation between owners of closely-held businesses. Not all litigation attorneys have handled these types of cases, which can be very tricky and idiosyncratic, because they are a hybrid between a regular business dispute and a divorce case. Sometimes there is a narrow opportunity to settle these cases at the inception if you can get all parties, their lawyers and their accountants in the same room. However, if you miss that opportunity, the parties

start slinging mud at each other, their positions harden, and it becomes impossible to settle until both sides start running out of money. As in most things, having a lawyer with specific experience handling closely held business owner disputes can be a godsend.

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ATTORNEYS MENTIONED

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