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DEAL WITH IT

Breaking Up Is Hard to Do: 'Business Divorces'

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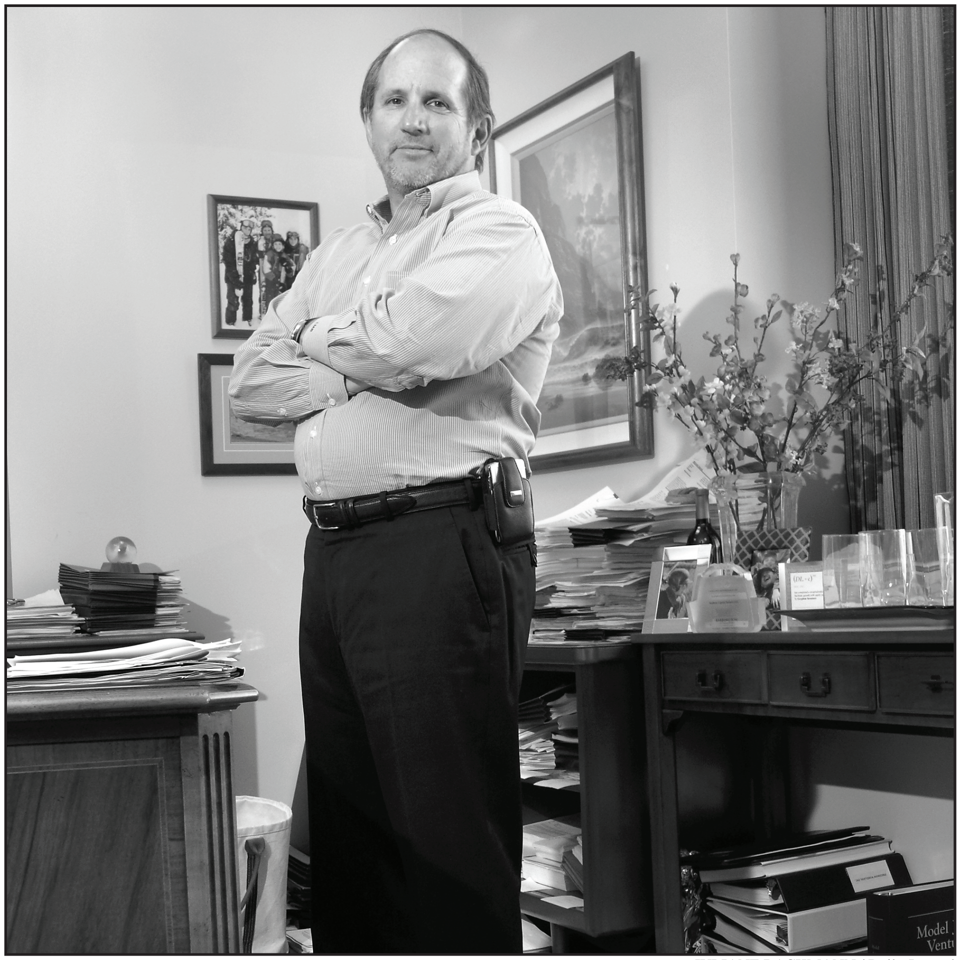

JULIANE BACKMANN / Daily Journal

A bad economy can strain even the best business partnerships, writes Sheppard Mullin's Lawrence Braun, but it can also provide the catalyst for a successful business divorce if it tempts the hesitant partner to get out while the getting is good — and if the remaining partner understands the roadblocks along the way.

Picture this: You and your partner have not been contributing equally to your business or seeing eye to eye for quite some time, but in good economic times and with a healthy income from the business you had let sleeping dogs lie. Or, you now see an opportunity to grow your business despite the ongoing uncertainty in the economy, and you can't get your cautious business "partner" to budge.

The world is changing rapidly and you and the business cannot sit still. Gritting your teeth, you tell yourself that if only you had sole control... things would change!

If it's any consolation, you're not alone; difficult times strain even the best business partnerships in many ways, often causing disastrous breakups and business failure.

On the other hand, a bad economy can provide the catalyst for a successful business divorce if it tempts the hesitant partner to get out while the getting is good — and if the remaining partner understands the roadblocks along the way to a breakup.

By a "business divorce," we mean a buy-out of an owner by the other owner or the business itself, whether it is a corporation, partnership, limited liability company or other form of enterprise. The more owners, the more complicated this process becomes.

But I have my rights!

In the corporate context the first thing to understand is that the minority owner — meaning anyone holding less than a controlling interest — fights against long odds in any business divorce. The law goes to some length to protect minority owners in any business enterprise, but in the real world, you need far more than the bias of the law to carry out a successful business dissolution.

In plain English, this means that if you own 49 percent of your business, don't fool yourself into thinking that you need only 1 percent more plus another dollar and you're home free. You're not.

A majority owner should not think that you can force the issue by taking the other owner to court, either. In the corporate context in California, if you own more than 33 percent of your business, you can force an involuntary dissolution only under very limited circumstances — and you probably can't force one at all if you own a smaller share. You can threaten to try, of course, in an effort to gain leverage, but you'd better be willing to risk losing everything before you make such a threat.

As it is, only 20 percent of privately held businesses survive into the second generation, and the number gets far worse for those who leave it to a judge to dissolve the business relationship.

Instead, your strategy should be to give your partner reasons to negotiate with you — amicably. You want to end the relationship with your partner without destroying the business itself, and you want all parties to come away satisfied, or at least equally unhappy.

Understand your real goals

How can I ever get this done? First of all, understand and set your real goals. Try to peel away your own emotions. Do you want your partner out of the picture altogether and right away, with no role in the business at all? As an alternative, could you use your partner's skills in making a transition — and tolerate his or her presence for as long as it takes to establish your own reign at the top? Do you want sole control? How about cutting your management team in on the deal or maybe your employees? How about recruiting another partner — for example, one with deep pockets and lots of faith in your vision such as a private equity group? Is an employee stock option plan a viable tool to accomplish your goals? How do you feel about taking on debt to do a deal with your partner? In this troubled economy, is debt even available?

Think through these questions carefully. Even thriving businesses fail under the stress of a business divorce, and the chances for disaster increase quickly when the partner seeking to gain control over the business changes his or her mind as to the ultimate goals part way through the process.

Keep in mind, this process will not be easy and will cost more and take longer than you think.

Step into your partner's shoes

The next step is to shape a strategy that will get you to your goals, possibly starting with an assessment of your partner's goals. Essentially, you need to try to "step into your partner's shoes" and think the way he or she thinks. How does your partner contribute to the success of your business? What does he or she want from the business venture? What might be the next step in his or her business life?

This is more difficult than you think. Sure you've been partners for years, but did you ever understand what he or she wanted? Also, things have changed, especially as you both grew older or as a result of the economic pressures of a bad economy.

This cannot be a casual exercise, you really need to try to understand your partner's goals and fully understand how those goals will impact a business divorce. Keep in mind that their goals may change during the process because of input from their own trusted advisors or spouse.

The pursuit of leverage

Assuming you've thought this through and are ready to proceed, what is this process going to look like? Will your long-standing relationship allow for open and honest communication and allow quick resolution of any issues? Or, more likely, will the process of ending the business relationship, like divorces between married couples, lead to high emotions, differences of opinion, stubbornness and a desire to punish the other party?

The short answer is... you never know. So hope for the best, but plan for the worst. Planning is the key.

One approach may be to show your partner that you want everyone to come out ahead so that you can foster a productive negotiation. But if you are going to take that approach, before you do, you need to look for leverage, in case the process turns sour. Another approach is to use your leverage coming out of the gate.

So look long and hard for leverage. You need to look carefully because you never know where you will find it. You have to consider if you are willing to leave if you cannot obtain the result you want. What about the importance of your own contribution to the success of the firm? What happens to revenues, for example, if you aren't in the picture? No one is irreplaceable, but in the business divorce card game, if you drive revenues, you hold a pretty good hand. The same is true if your personal or business relationships are key to your firm — for example, relationships with vendors and customers.

You also need to examine the "dark side." This is the area where you review how you and your partner have conducted your business in the past and whether there were activities or arrangements which one or both of you want to keep confidential. Such arrangements need to be considered from all angles.

A real analysis of the leverage both parties have is key to developing a strategy to obtain a business divorce while keeping yourself and your business intact. You cannot do this on a superficial level, but rather you need to devote the time and effort to help you get the result you want.

Where do I start and how do I do this?

Don't try to do this by yourself. Don't try to negotiate your deal alone. The distraction and time you will spend doing so will hurt your business. Also, it is difficult to be objective in these circumstances.

You will need a team that may include the help of legal, investment banking, accounting and even estate-planning experts to come up with a structure and financing and to settle details such as non-compete agreements and post-sale consulting arrangements, not to mention the tax implications of the sale for yourself and your partner alike. The tax side of these transactions is a key element of making it work for everyone.

Take a deep breath and get started

The objective is to ultimately get you and your partner to agree on an amicable separation, so don't let it come as a surprise when your interests clash. Your partner will probably want cash up front, delivered with as little and favorable taxation as possible, while you may want a buyout payable over time, with favorable tax consequences to you or your company, depending on the legal structure of your deal.

These and other questions can loom large in the middle of a business divorce; indeed, they can appear very threatening. But don't let them kill the deal. It's tough enough to end a business relationship in good times. In hard times like these, it's even tougher — but still doable if you plan ahead and keep your eye on the goal.

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