

The Business Divorce

By John G. Schmidt Jr. and David J. Murray

Phillips Lytle LLP

Eight years ago, you and your business partner launched your business with great promise. You painstakingly developed a business plan, determined your roles, and put it in writing. For years you thrived. But now, one of you wants out. Or, worse, you've discovered insurmountable problems. Like a marital divorce, a business breakup can get complicated.

The extent to which your business divorce will be relatively free from stress and financial hardship will depend largely on how carefully you set up your business on the front end. If you have discovered malfeasance or dishonesty, you may need to take prompt legal action to mitigate harm to the business and your investment or recoup damages caused by the wrongdoing.



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The Business Divorce Process — Dissolution

Disputes typically arise from disagreements over daily operations or strategic direction, compensation, suspected self-dealing or breaches of other fiduciary duties, inadequate financial reporting or disagreements over funding the business. Differing values, changes in interests, disparate risk tolerance, unequal effort or poor health are also common in business divorces.

Not all business divorces result in dissolution. In many cases, the resolution will be a purchase of one principal's interest by the other, or a sale of the business as a going concern. Because of their complexity and financial implications, let's focus on dissolutions.

Whether your business is an LLC, corporation or partnership, the same basic legal rubric applies for dissolution:

- Review the charter documents (e.g., articles of formation, bylaws) and agreements among the principals (e.g., shareholder or operating agreement) to determine what is required for dissolution. Absent written agreements, the process may default to the applicable statute governing the entity's formation and existence.
- Take the necessary actions to dissolve the business. Depending on the business and the terms of the controlling agreements and statutes, these actions might include negotiations, voting to dissolve, governmental filings, written notice to your partners or other constituents, or litigation regarding disputed areas.
- Cancel registrations, licenses, permits and business names; and provide public notice.
- Terminate contracts and leases; address employment issues, client transitions and media inquiries; pay debts; and file tax returns.
- Collect receivables, liquidate inventory and equipment, and close bank accounts.
- Protect, dispose of, and/or assign intellectual property, confidential business information and client information, while ensuring the security of electronic data.

- Maintain a post-dissolution reserve of funds to address any contingent liabilities, if necessary.
- Evaluate the need for post-dissolution insurance coverage.

Strategy on the Front End

No one goes into business planning an exit, but strategic legal preparation can ease the risk of future problems.

An important first step is to hire an attorney with the appropriate skill set to work with you and draft governance documents and agreements that plan for a business breakup by including specific provisions on how to end, value or restructure the business. Each principal should have his or her own

attorney for this process.

Strategy on the Back End

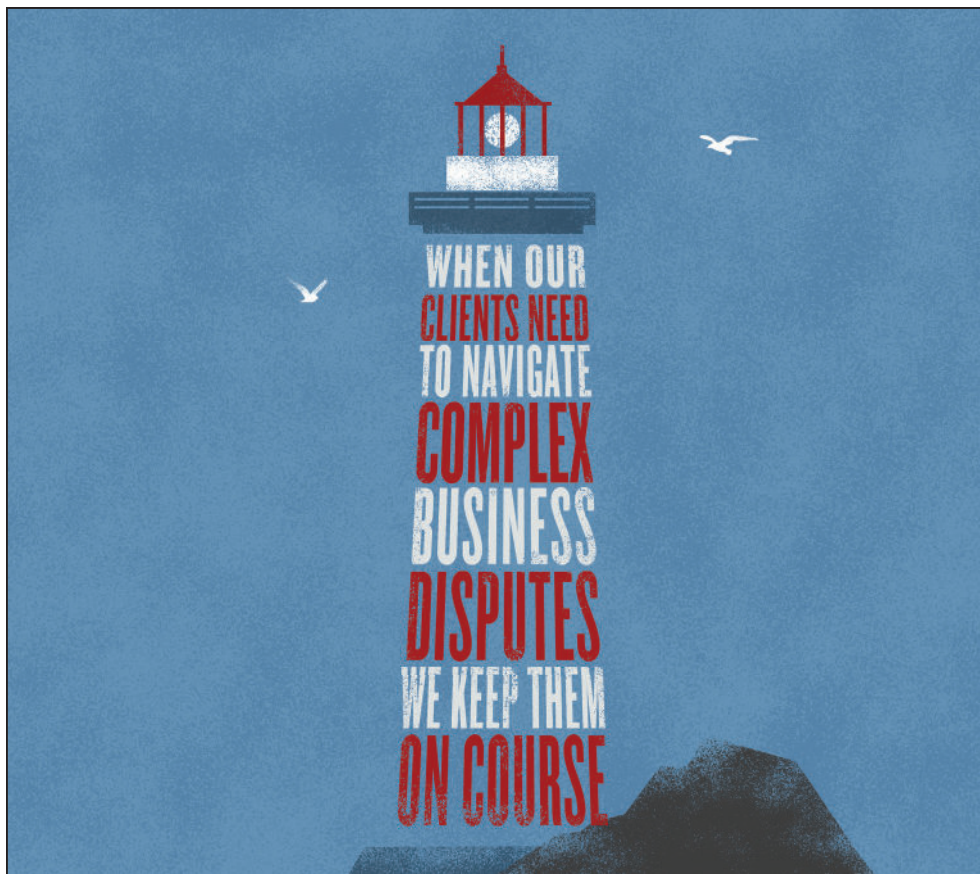
What if you are already there and your documents do not address what you are facing? You need an exit strategy (for you or your partner(s)). Legal advice from independent counsel is critical. In addition, a public relations strategy allows you to frame the narrative if there are media, client or government inquiries. If there is fraud or other misconduct, it should be investigated and addressed, potentially in litigation. Confidentiality and focus are necessary to avoid collateral damage.

Weathering a business breakup can be disruptive. Poorly thought-out corporate

documents on the front end and a lack of experienced legal advice on the back end can make it more so.

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