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Making legal matters easy and economical for your business

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## Newsletter, April 2017 Using Buyout to Resolve a Deadlock

This article explains how to use buyout to resolve a shareholder deadlock. Usually a deadlock occurs when there are two warring sides, each owning 50% of the business. The two sides can't agree on anything, and neither side can get what it wants because it's blocked by the other.

### Unilateral Action -- Probably Won't Work

When a client consults with me, usually the first question is, how can I unilaterally get rid of the other side? For example, how can I fire those jerks? The answer is, you probably can't because they'll block the action – that's how deadlock works. Likewise, those jerks can't fire you. In a 50/50 deadlock, unilateral action usually is invalid, and leads to both sides calling their lawyers.

Next, one side (side #1) might think, *first*, of selling the entire practice or business to a third party buyer, or *second*, selling side #1's 50% ownership to a third party. But side #1 can't sell the entire practice to a third party, because side #2 will block the sale. And it's difficult for side #1 to sell its 50% ownership to a third party, because most likely a Shareholders Agreement will prohibit the transfer, and furthermore, no third party will pay good money to buy into this mess. No one wants to buy a lawsuit.

Fine, says side #1, I'll blow the whole damn thing up. Dissolution is the nuclear option. CA law permits the shareholders with 50% or more of the voting shares to file for dissolution. Hence one side may unilaterally dissolve the business. When side #1 threatens dissolution, it's really offering a choice to side #2 – either you buy me out, or we both get nothing (except a lawsuit against each other). In general, it's best not to make this type of threat, but I never bet against insanity.

### What Might Work

When faced with a deadlock, the first place to look for a resolution is the Shareholders Agreement. That contract might have terms that permit a buyout. Over the decades, I've seen many interesting provisions in Shareholders Agreements.

If the Shareholders Agreement doesn't help, then try to settle. Rational people resolve their disputes through settlement. I'll devote the rest of this article to explaining the key points of the settlement.

Settlement usually involves side #1 buying out the shares of side #2. This leaves side #2 with money and the freedom to try something new in life. Side #1 gets 100% ownership of the business or practice, including its EIN, contracts (including the all-important insurance and Medicare contracts), office lease, equipment, and liabilities.

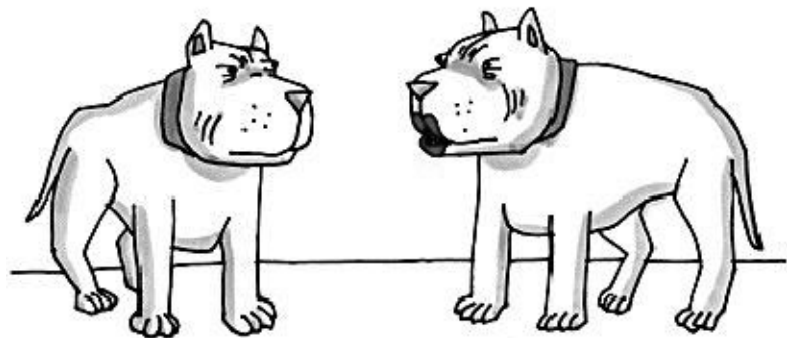
When structuring a buyout of shares, keep your eyes on the following:

Name and EIN	The buyer of shares keeps the corporation's name, fictitious names and tax ID number (EIN).
Contracts, including Lease	The side that keeps the corporation also keeps its contracts in place. Sometimes the contracts are key assets of the business, for example, the office lease, or contracts with insurance companies and Medicare (which can take months to replace, leading to gaps in collections).
Client and Patient Allocation	Service businesses will need to allocate the patients and clients between the two sides. This includes allocation of the patients and clients of employee service providers, e.g. associate doctors.
Employee Allocation	The two sides cannot allocate employees. Employees are not serfs who get bought and sold with the land. Instead, employees choose where to go.
Hard Assets	The buyer of shares gets the corporation and all of its hard assets including equipment.
Phone and Website	Likewise, the phone number and website stay with the corporation into the buyer's hands.
Collection of A/R	Be sure to provide a mechanism for the collection of the seller's accounts receivable after the buyout, that is, either the buyer collects on behalf of the seller, or the seller has the right to directly collect its own A/R.
Guaranties	Guaranties (most likely for the office lease) are wildcards in the structure, especially if the seller of shares has a guaranty of the office lease that remains after the buyout. Landlords usually do not release guaranties, leaving the seller of shares with a potential liability after leaving the business.
Non-Competition Clauses	I advise against imposing non-competition covenants as part of the buyout. No-competes are difficult to negotiate and frequently make settlement near impossible (because the selling side still needs to make a living).

Lastly, be patient in these matters, because resolution takes time. Above all, be professional and decent, because resolution requires trust between the two sides. Deals get done on trust.

## William James:

- Our errors are surely not such awfully solemn things. In a world where we are so certain to incur them in spite of all our caution, a certain lightness of heart seems healthier than this excessive nervousness on their behalf.
- Be willing to have it so. Acceptance of what has happened is the first step to overcoming the consequences of any misfortune.



*“There’s more than one way to catch a mailman.”*