



MATT DICKSTEIN

Business Attorney

Making legal matters easy and economical for your business

39488 Stevenson Place, Suite 100, Fremont, CA 94539

510-796-9144. matt dickstein@hotmail.com matt dickstein.com

Newsletter, March 2011

Using Involuntary Dissolution to Resolve Shareholder Disputes

Shareholders and partners are like married couples: they fight. It makes no difference that the dispute is between deadlocked equal partners, or between minority and majority shareholders. In both cases, the shareholders and partners need a divorce.

Enter involuntary dissolution, which is your nuclear (that is, your final) resolution. Involuntary dissolution is a judicial process where the court separates the warring partners by forcing a sale of ownership from one to the other, or by forcing a sale of the entire business. You use this process when all else has failed for a dispute between owners of a corporation or an LLC in California.

First, Check Your Buy-Sell Agreement. Before you do anything else, check your buy-sell or shareholders agreement to see if it has provisions that control the dispute. [That's why all businesses should have a buy-sell agreement – to control over shareholder disputes.] In this article I assume that no buy-sell agreement controls the dispute.

Second, Settle. Before going to court, try to settle the dispute. The parties should negotiate their divorce, perhaps by one shareholder buying out the other or the sale of the entire business. Mediation is a good place to conduct the settlement negotiation. Only consider going to court for the involuntary dissolution when all else fails. Litigation is very expensive and after the payment of lawyers like me, everyone else is a loser.

Third, Involuntary Dissolution. As mentioned, you obtain involuntary dissolution through the courts. Who can sue for involuntary dissolution under California law? - 1/2 of the directors, or shareholders owning 1/3 or more of the stock can sue for involuntary dissolution. Usually the grounds for dissolution are deadlock on the board of directors, or that a majority / controlling group of shareholders is committing bad acts to the detriment of minority shareholders.

In California, a judge, not a jury, decides the involuntary dissolution. The judge can decide the matter early in the case at a hearing, before trial. Once the judge decides to dissolve the business, the board of directors of the company go about winding up its affairs and liquidating its assets, subject to the court's supervision. The court can order the sale of the business as a going concern, or by piece-meal liquidation. At the end of the winding-up process, the court declares the dissolution of the corporation and a copy of the order is filed with the California Secretary of State.

Buy-Out Rights. The holders of 50% or more of the voting stock of the company have the statutory right to purchase for cash the shares owned by the plaintiffs in the involuntary dissolution. This avoids the dissolution of the company. Note that the party who files for the dissolution does not have a statutory buyout right. The court determines the purchase price using a panel of 3 appraisers, who fix the price at liquidation value as of the date of filing of the dissolution complaint. The appraisers are another reason to settle early. You're stuck with the value they put on the business, and worse, you must pay their appraisal fees no matter how crazy you think their value is. That's adding injury to insult.

Ancillary Claims for Damages. Although the process for involuntary dissolution is simple, the warring partners make things complex. Each warring partner usually has a related claim for damages against the other, for example fraud, embezzlement, etc.

These ancillary claims for damages bring risk and pressure to the process. First, these claims require more legal procedure, time and money. Second, they can be decided by a jury (as opposed to a judge alone) and no one can predict what a jury will do. Third, all of the parties' anger and spite are tied up in the ancillary claims.

I've noticed over the years that the warring partners get so wrapped up in their claims for damages that they lose sight of the big picture, that being how to separate themselves ASAP with minimum loss. Partners who maintain a broader perspective don't even go to court – they settle their problems early and save a lot of money.

I hope this article is useful to you. As always, I only glossed over the outlines of the subject. Call me if you need to talk more.

Ideas:

"Learning how to think" really means learning how to exercise some control over how and what you think. It means being conscious and aware enough to choose what you pay attention to and to choose how you construct meaning from experience. The really important kind of freedom involves attention, and awareness, and discipline, and effort, and being able truly to care about other people and to sacrifice for them, over and over, in myriad petty little unsexy ways, every day. –*David Foster Wallace*

Moral cowardice that keeps us from speaking our minds is as dangerous to this country as irresponsible talk. The right way is not always the popular and easy way. Standing for right when it is unpopular is a true test of moral character. –*Margaret Chase Smith*

Ham and eggs...A day's work for a chicken, a lifetime commitment for a pig. –*Anonymous*



